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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1203

C. ORVIS SOWERWINE, Trustee in Bankruptcy,
REA Express, Inc., *Appellant*

v.

UNITED STATES OF AMERICA, INTERSTATE COMMERCE COMMISSION, ALABAMA GREAT SOUTHERN RAILROAD COMPANY, ET AL., *Appellees*

STATEMENT AS TO JURISDICTION

ROBERT L. WRIGHT
1750 New York Ave., N.W.
Washington, D. C. 20006

ARTHUR M. WISEHART
150 E. 42nd St.
New York, N. Y. 10017

Attorneys for C. Orvis Sowerwine, Trustee in Bankruptcy of REA Express, Inc., a Bankrupt.

WISEHART, FRIOU & KOCH
150 E. 42nd St.
New York, N. Y. 10017

Of Counsel

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TABLE OF CONTENTS

Page

STATEMENT AS TO JURISDICTION

Opinions Below 1

Jurisdiction 2

Statutes Involved 3

Questions Presented 3-4

Statement 4

The Material Facts 5

The Questions Are Substantial 11

A. Section 10, As Construed By This Court, Was Violated By The 1959 Note Issue 11

B. Section 20a(2), As Construed By This Court, Required Commission Disapproval Of The 1959 Note Issue 15

C. This Court's Definition Of Creditors' Equitable Rights Requires A Return Of The 1960-1971 Interest By The Railroads To REA's Trustee 18

Conclusion 22

TABLE OF AUTHORITIES

JUDICIAL DECISIONS:

Denver & R.G.W.R. Co. v. *United States*, 387 U.S. 485 (1967) 9, 16, 17

Gulf States Utilities v. *FPC*, 411 U.S. 747 (1973) 17

Minneapolis & St. Louis Railroad Company v. *United States*, 361 U.S. 173 (1959) 13, 14

Pepper v. *Litton*, 308 U.S. 295 (1939) 20-21

Railway Express Agency, Inc. v. *Internal Revenue Service*, 169 F.2d 193 (2nd Cir. 1948) 19

United States & Mexican Oil Co. v. *Keystone Auto Gas & Oil Service Co.*, 19 F.2d 624 (W.D. Pa. 1924) .. 18

In re Hawkeye Oil Co., 19 F.2d 151 (D. Del. 1927) 18

Page

COMMISSION DECISIONS:

Railway Express Agency, Inc. Notes, 348 ICC 157 (1975) 1
Express Contract, 308 ICC 545 (1959) 7, 9, 12, 15
Securities and Acquisition of Control of Ry. Express Agency, Inc., 150 ICC 423 (1929) 6

STATUTES:

Clayton Act, § 10 (15 U.S.C. § 20)...3, 11, 12, 13, 14, 17, 18
Interstate Commerce Act, § 20a(2) (49 U.S.C. § 20a(2)) 3, 12, 15, 17, 18
Interstate Commerce Act, § 5(1) (49 U.S.C. § 5(1)) .. 3, 9

CONGRESSIONAL REPORTS:

House Judiciary Committee, No. 627, 53rd Cong., 2nd Sess., May 7, 1914 ..... 11-12, 14

TEXTS:

MacVeagh, *The Transportation Act of 1920* 11

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STATEMENT AS TO JURISDICTION

OPINIONS BELOW

The opinion of the three-judge District Court, also sitting by special designation as the Court of Appeals for the Second Circuit, is not yet reported and appears at 1a-34a.[1] That decision affirmed a decision of the Interstate Commerce Commission, approving the issuance of more than 27 million dollars, worth of 14-year, non-negotiable notes by REA Express, Inc., hereinafter REA, to its stockholders. The approving order is unreported and appears at 97a-99a. The Commission's supporting opinion is reported in Railway Express Agency, Inc. Notes at 348 ICC 157, and appears at 44a-96a. Appellant, C. Orvis Sowerwine, is REA's Trustee in Bankruptcy.

[1] All page references with suffix a are to the attached appendix.

JURISDICTION

Judgments were entered on the foregoing opinion on November 18, 1976 in both the District Court and the Court of Appeals (35a). The Bankruptcy Court authorized the Trustee to appeal from the District Court judgment on January 14, 1977 (38a), and a Notice of Appeal to this Court was filed in the District Court on that day, invoking the jurisdiction of this Court pursuant to 28 U.S.C. § 1253 (37a). The three-judge Court suggested that its jurisdiction was probably that of a statutory District Court (9a), but did not decide the matter.[2] On February 7, 1977, Petitioner moved this Court for an extension of the time within which a jurisdictional statement and petition for certiorari might be filed. On February 10, 1977, Mr. Justice Marshall granted the extension on the following terms: "... that the time for filing a petition for writ of certiorari and/or for docketing an appeal in the above-entitled cause be, and the same is hereby, extended to and including March 1, 1977, without in any way passing upon the jurisdiction of this Court to entertain such petition or appeal." Appellant asks that if this

[2] The Act of January 2, 1975, Pub. L. No. 93-584, referred to by the Court below, appears at U.S. Code Cong. & Admin. News, Volume 2, 93rd Cong., 2nd Sess., 1974, pp. 2203-2204. Its legislative history is found in Volume 4 at pp. 7026-7043. As noted at page 7028, there was "no time limitation for challenging a Commission order" in the then existing law. The Commission's order approving the 1959 note issue (97a-99a) was directly attacked in REA's 1972 amendment to its complaint. This resulted in the convening of the three-judge District Court and the Commission's intervention to reconsider its 1959 order (100a-106a). As the Court below noted, Section 10 of the 1975 law provides that then-pending three-judge District Court actions "shall proceed to final disposition" under the pre-existing law (9a). We take this to mean that the decision below is reviewable upon direct appeal to this Court.

Court regards the decision below as reviewable only on certiorari, this Statement may be treated as a Petition for such review.

STATUTES INVOLVED

The principal statutes involved are Section 10 of the Clayton Act, 15 U.S.C. § 20, and Section 20a(2) of the Interstate Commerce Act, 49 U.S.C. § 20a(2). They are set forth, in relevant part, in the Opinion below at 14a-15a and 11a-12a. Section 5(1) of the Commerce Act, 49 U.S.C. § 5(1) is also involved and appears in relevant part at 18a-19a.

Section 10 prohibits directors and managing officers of a common carrier from issuing securities of the carrier without competitive bidding when they act for both the carrier and those who receive the securities. Section 20a(2) requires the Interstate Commerce Commission to investigate and disapprove a common carrier's issuance of securities unless it finds that the issuance will be in the public interest.

Section 5(1) prohibits the pooling of net earnings among competing common carriers unless (a) all of the carriers involved consent to the terms of the pool and (b) the Interstate Commerce Commission finds that the pooling is in the public interest.

QUESTIONS PRESENTED

1. Are Notes Issued by a Common Carrier to All of its Stockholders in Proportion to their Respective Stockholdings Within the Coverage of Section 10 of the Clayton Act?

2. May the Commission Approve Such an Issue Pursuant to Section 20a(2) of the Commerce Act Without Finding Any Resulting Public Benefit?

3. Are General Creditors Defrauded When Carrier Stockholders Convert Capital Claims Into Unsubordinated Long-Term Notes?

STATEMENT

REA was adjudicated a bankrupt on November 6, 1975 and ordered liquidated. Appellant-Petitioner, C. Orvis Sowerwine, hereinafter Trustee, is REA's liquidating Trustee. REA was organized in 1928 as a nonprofit common carrier of express shipments, cooperatively operated for their mutual benefit by 86 Class 1 railroads and approximately 300 shortlines (48a). In 1959, it was reorganized as a profit-making carrier with a legal right to contract freely for express shipments with rail, air, and motor carriers, although it continued to be railroad-owned (75a-77a). In 1969, it was sold to its principal managing officers who, in 1971, caused it to sue its former railroad owners for antitrust damages allegedly arising out of the 1959 issuance of more than 27 million dollars, worth of 14-year, 5% nonnegotiable notes to its stockholders in exchange for obligations resulting from capital contributions. The notes were then repudiated by REA and the suit was filed on the ground that their issuance violated Section 10 of the Clayton Act, having occurred without competitive bidding, and that their issuance was also a breach of trust (5a-6a).

Because the Interstate Commerce Commission had approved the note issue in 1959, a three-judge District Court was convened in 1972 to hear the case. The Commission then intervened for the purpose of re-examining the merits of its 1959 Order (7a). An Administrative Law Judge initially concluded that the note issue was void for want of consideration (82a-83a). After a voluminous record was made, the Commission

concluded in 1975 that the note issue had been validly approved in 1959 (96a). After a petition for reconsideration was denied, (110a) the Bankruptcy Court authorized the Trustee to seek judicial review and reversal of the Commission's decision (7a, n. 2). The Trustee did so by filing similar petitions in both the District Court and the Court of Appeals for the Second Circuit.

After argument before the three-judge District Court, also sitting by special designation as a Second Circuit Court of Appeals, the Court affirmed the Commission (33a-34a). The Court's Opinion omits some relevant, undisputed facts, that we shall state here.

THE MATERIAL FACTS

As the opinion notes, REA's 1000 shares of capital stock were issued to its 86 railroad owners in proportion to the express business previously handled by each (2a-3a). REA's capital assets and working capital were obtained by a 32 million dollar bond issue sold to the public in 1929 (3a). The $100,000 capital stock represented merely "the voting rights" (48a).

There was no provision for profits or dividends as REA was to be operated as a vehicle for cooperatively handling all of the express business of all of the railroads, including the 300 shortlines that owned none of its stock. Its net profits were to be distributed among all of the railroads handling express shipments in proportion to the shipments handled by each (49a). That is why the 1929 Standard Express Operating Agreement, hereafter SEOA, between REA and each of these railroads, was submitted to the Commission as a net earnings pooling agreement, requiring approval under § 5(1) of the Interstate Commerce Act, 49 U.S.C.

§ 5(1); Securities and Acquisition of Control of Ry. Express Agency, Inc., 150 ICC 423.

The 1929 bond issue provided for a sinking fund that would retire $800,000 of the bonds semi-annually. The 1929 SEOA provided that the sinking fund payments would be made before any distribution of net earnings to the railroads (3a). As the Court below pointed out, had this been done, "the non-negotiable debt never would have been created." (19a). While the Commission expressly disclaimed approval of that provision in its 1929 opinion approving the pooling of REA's earnings (150 ICC 423, 434), no SEOA providing for any different treatment of the sinking fund was ever submitted to the Commission for approval.[3]

Although the stockholding railroads were only 86 of the 300 odd recipients of REA's net revenues, they had REA treat each sinking fund payment as an advance from them by deducting it from their respective shares of REA's net revenues (3a). On these "advances" they then paid themselves a higher rate of interest than the public bonds carried (119a). These interest payments were an operating expense deducted for REA's gross earnings before distributing their respective shares of the net earnings to all of the railroads doing business with REA.[4]

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[3] There were two additional SEOA's approved by the Commission in 1954 and 1959, respectively. Neither referred to the sinking fund practice by which REA's public debt was to be retired because that debt had been fully retired in 1946 (131a).

[4] The effect of the foregoing treatment of REA's capital debt upon its operating expenses, its capital available for needed improvements and its express rates is summarized in the sworn statement of L. John Eichner ,a transportation expert offered by REA. His statement dealing with these matters appears in part at pp. 121a-131a. It was ignored by both the Commission and the Court without explanation.

In 1938, REA refunded the then outstanding public bonds at a lower interest rate and retired this public issue from REA's operating revenues in 1946 (131a). As these bonds were retired, the sinking fund payments and the final retirement payment were also treated as advances from the stockholders and the bookkeeping debt so created carried a higher rate of interest than the bonds had (119a). The railroads disclosed to the Commission in 1938 that this was the way they proposed to handle retirement of this public debt and the Commission made no objection. There was no Commission action with respect to the proposal because its Director of Finance told the railroads that they need not submit this proposal for approval (4a).

The net result of the foregoing 1930-1958 bookkeeping and Commission inaction was that by 1959, $28 million had been paid to REA stockholders as interest on their capital advances (131a), and REA's books still showed a capital debt of more than $27 million to REA's stockholders.

In 1959, REA was threatened with liquidation because, *inter alia*, it had been obliged to give rail transportation a preference in contracting for express services (Express Contract, 1959 308 ICC 545, 546-547). As an alternative to liquidation, REA's Board received an offer from Lehman Brothers to buy the railroad owners' stock for $500 a share and to liquidate its capital debt in two years at 4% interest (pp. 111a-113a). That offer was conditioned, however, on prompt and complete independence for REA in routing its express shipments. The Southern Railroad objected to such a sale on the ground, *inter alia,* that it would:

> ". . . create an adversary who will demand from us before public authority at least line haul serv-

ice at rates which we do not regard as compensatory. I would rather stay where I am than to take this step.

"Perhaps we should seek to have the Agency [REA] agree that it will not dispute with us about such matters before public authority, agreeing to accept our tariffs or to take the business elsewhere." (114a.)

The Southern's objection was also based on the fact that a sale to Lehman Brothers would,

"... run the risk of creating a situation where for sound business reasons the business would be liquidated under circumstances which might be inconsistent with our larged interest, as indeed we have thought it would be. I agree it would perhaps not be as bad as liquidation now, but the only improvement for me is in the element of time." (116a.)

The Lehman Brothers offer was not accepted and REA's Board concluded that it should be reorganized on a basis where it would gradually attain a contractual freedom of choice in routing express shipments but would be kept in railroad hands. The twenty-seven million dollar capital bookkeeping debt to REA's stockholders, although then subordinated to all non-funded debts (72a-73a), was to be converted into 14-year, 5% non-negotiable notes, subordinated only to other existing bond issues. A recommendation that the notes be subordinated as the capital debt had been, made by an REA Vice President, (120a-121a) was not followed. This conversion required Commission approval pursuant to § 20a(2), as being in the public interest.

An application for such approval was filed on August 31, 1959 and granted on September 25, 1959, without an investigation, hearing or an opinion, by the unpublished order appearing at 97a-99a. A hearing had been held on August 18, 1959, pursuant to § 5(1) to consider the 1959 SEOA. The agreement terminated the prior railroad preference in contracting for express transportation as of 1961, terminated the interest of the shortlines in REA's net profits and relieved the railroad parties of certain contingent liabilities in the event of REA's liquidation. In its opinion approving the 1959 SEOA (308 ICC 545), the Commission applauded the new agreement as a step toward saving REA from liquidation but said nothing about the conversion of REA's book debt to its stockholders into a 14-year, fixed debt, carrying 5% interest.

A 1963 sale of REA stock to the Greyhound Bus Company was aborted by this Court's decision in *Denver & R.G.W.R. Co.* v. *United States*, 387 U.S. 485 (1967). In 1968, the railroads turned REA over to three individual trustees for sale They recruited a new management and sold the company to that management in 1969. The new management repudiated the 1959 note issue in 1971 when REA filed its antitrust suit. No further interest or principal was paid and the railroad owners, claims on the 1959 notes, when REA filed its petition under chapter XI of the Bankruptcy Act on February 18, 1975, totalled more than twenty-seven million dollars in principal and nearly six million dollars in interest (39a).

Nine months later, REA was adjudicated a bankrupt. The Trustee has not yet realized sufficient cash from the sale of REA's assets to make any payment on account of pre-filing claims of creditors, which total about forty million dollars, exclusive of the claims on the 1959 notes (40a).

The undisputed claims against the bankrupt estate include in excess o f$11,000,000 of claims reflecting the vested vacation benefits of employees of REA, most of whom were also employees at the time the notes were issued in 1959. In addition, there are over 400 former employees, retired prior to January 1, 1964, who presently have claims for unpaid pension benefits. These benefits were not funded and accordingly were cut off as of February 18, 1975, when REA filed its Chapter XI petition. The amount of the claims of these pensioners is estimated to be approximately $1.5 million.

The Commission's 1975 opinion affirmed its 1959 Order approving the note issue upon the ground that the debt converted into notes was validly owed to REA's stockholders (96a). It gave no consideration to the impact of this conversion upon REA's ability to avoid liquidation or upon REA's charges to the public for express service. The Commission's conclusions rationalized the "advances" creating the underlying debt as consistent with prior Commission policy and as made to satisfy the position on liquidation desired by REA's railroad owners (83a-87a). REA creditors' rights were ignored.

The Court below thought that because REA was a railroad agent for express service it needed no surplus of its own and that it made no difference whether REA's express revenues were used for express service or to satisfy cash needs of its railroad owners (17a). Since any REA gain or loss would be reflected in gains or losses for the railroad owners and they were solely responsible for REA's financing, what satisfied them should satisfy the public and the Commission (29a). REA's bankruptcy was regarded as unaffected by the 1959 note issue because REA made money in 1974 (32a).

THE QUESTIONS ARE SUBSTANTIAL

A. Section 10, as Construed by This Court, Was Violated by the 1959 Note Issue.

The decision below, unless reversed, may emasculate public control of common carrier security issues. Section 10 was held to have no application to the conversion of capital debt into 14-year notes, unsubordinated to general creditors, because the note holders comprised all of REA's stockholders. This is the precise situation in which the securities manipulation prohibited by Section 10 is easiest to accomplish.[5] Section 20a(2) was held not violated by this note issue, merely because the notes replaced debt previously shown on REA's books; with no consideration of the impact of the note issue on REA's ability to serve the public.

Section 20a was Section 439 of the Transportation Act of 1920 (41 Stat. 494), a statute that also established in Section 501, a 1921 effective date for the 1914 Clayton Act's Section 10 (41 Stat. 499). A provision for Commission control over the issuance of all common carrier securities similar to 20a had been passed by the House in the 1914 Congress that enacted Section 10. *See* MacVeagh, *The Transportation Act of 1920,* 486-489.

The 1914 origin of both Sections 10 and 20a was President Wilson's message of January 20, 1914, outlining his program for outlawing "private monopoly." Section 10 was originally Section 9 of H.R. 15457, which, according to the Report of the House Judiciary Committee, No. 627, 63rd Cong., 2d Sess., May 7, 1914,

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[5] A dissenting stockholder has private injunctive remedies which tend to prevent abuses of fiduciary relationships that injure minority stockholders.

was meant to implement Wilson's promise to prohibit the corporate interlocks that make "those who borrow and those who lend practically one and the same" (p. 18).

These sections were both enacted because the decisions of carrier stockholders had notoriously failed to guard the public interest in sound carrier financing. The Interstate Commerce Commission reviews all important carrier security issues under 20a(2) and must of course give especially careful consideration to the public interest, where, as here, the stockholders benefit themselves.

The 1975 Commission did not claim that it or the 1959 Commission considered the Clayton Act question raised by the 1959 note issue, in the 20a(2) proceeding that resulted in approval. The 1975 Commission held instead that the note issue had been approved by the 1959 decision approving the 1959 pooling agreement (95a-96a). That 1959 decision (308 LCC 545) did not mention the note issue but the proposal to issue the notes was mentioned in the 1959 testimony of REA's President about the pooling agreement (96a). This led the 1975 Commission to conclude that the 1959 decision approving the pooling agreement had immunized the subsequent note issue from any Clayton Act attack (96a).

Although the United States argued below that the foregoing Commission decision made it unnecessary for the Court to consider the applicability of Section 10 to the note issue, the Court below did not accept that argument. It rested its decision instead upon its own construction of Section 10 as excluding notes issued to a carriers' stockholders in proportion to their stockholdings.

This Court, after consideration of Section 10's legislative history, noted that it was meant to cover "a carrier's dealings with related persons in its own securities." *Minneapolis & St. Louis Railroad Company* v. *United States,* 361 U.S. 173, 190, n. 13 (1959). The Court below, on the other hand, said that "there is simply nothing to indicate that Congress meant that provision to cover a securities transaction between a carrier and all its owners" (29a).

The Court below then justified its refusal to read the statute literally, and as interpreted by this Court, by saying that "the Commission did not consider it to be applicable" because the 1959 Commission did not require "competitive bidding" (30a). One obvious reason why the Commission did not require competitive bidding is that no alternative means for dealing with the capital debt converted into the 14-year 5% notes was considered.

The 1959 Commission was not told that an offer had been made by Lehman Brothers, just before the notes were issued, to pay off this debt in two years, by an extension of the debt at the then-existing 4% interest rate (111a). This offer was, however, conditioned upon operation of REA as an independent carrier, with complete freedom to invoke a Commission judgment as to the reasonableness of the rates charged to REA by the railroads for express service (112a). That proposal was objected to by the Southern Railroad as one which would create an undesirable "adversary" relationship between REA and the railroads (114a).

Whether or not the public would have been better served by a genuinely independent REA, free of its $27 million debt to the railroads in 1961, or by a nomi-

nally independent REA, heavily indebted to its railroad owners, was a matter never considered by the 1959 Commission.

The 1975 Commission and the Court below were plainly wrong in limiting their appraisal to the before and after situation of REA "vis-a-vis its owners" (29a). Its owners chose to reject a rapid liquidation of their capital debt and prompt termination of their collection of interest charges, in favor of a fourteen-year prolongation of those charges. The result was the payment of thirteen more million in interest charges to themselves during 1961-1970, with this capital debt remaining unliquidated but placed on a par with debts owed to other creditors.

The 1959-1973 cost to REA was the difference between two years interest at 4% on $27 million and fourteen years interest on the same amount at 5%, or a difference between a total interest cost of slightly more than $2 million and a total interest cost of nearly $19 million. Section 10 covers no carrier financing if it does not embrace non-competitive financing that so inflates the carrier's costs.

Unless the Justice Department now reverses itself, the United States will not support the novel construction of Section 10 announced by the Court below; nor may this Court affirm it without overruling its 1959 decision in *Minneapolis & St. Louis Railroad Company* v. *United States,* 361 U.S. 173.[6]

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[6] The Brief for the United States asserted that "the typical kind of transaction" at which Section 10 was aimed was one in which the carrier's own securities were issued to persons related to it (p. 63, n. 22), citing the House Report referred to above. The Court restricted Section 10's coverage to "a carrier's dealings with related persons in its own securities" in n. 13, at 361 U.S. 173, 190, as heretofore noted.

B. Section 20a(2), as Construed by this Court, Requires Commission Disapproval of the 1959 Note Issue.

By its literal terms Section 20a(2) requires Commission "investigation" of the public merits of carrier securities issues before they may be approved as in the public interest. The principal question posed to the Commission by 20a(2) was not, as the Commission and the Court below thought, were the notes issued to liquidate a debt? (31a). The question for 20a(2) decision was, did a sound public interest ground exist for the conversion of REA's 1959 capital debt into the 14-year notes that the stockholders received?

This was far from the only alternative to REA's liquidation. Quite apart from that provided by the Lehman Brothers offer, an offer that any investigation would surely have disclosed, an issue of preferred stock would have assured the stockholders of a reasonable preference on liquidation without burdening REA with annual payments to its stockholders that could not be justified by its earnings. If the true purpose of the reorganization of REA was what the Commission said it was, rehabilitation of REA as a profit-making entity, (308 ICC 545, 550) making its owners dependent on earnings for their return on their investment in REA was far more consistent with that purpose than saddling it with 14-year, 5% notes.

An odd aspect of the opinion below is its reliance on the Lehman Brothers offer to show that these investment bankers "considered REA to be a viable enterprise" (31a-32a). It is apparent on the face of the offer that it was only considered a viable enterprise by Lehman Brothers if independently owned and operated (112a-113a). Moreover, the opinion below was wrong in suggesting that the bookkeeping debt's "con-

version into a debt maturing on December 31, 1973" helped REA (32a). Converting this capital debt into fixed debt maturing in 1973 simply assured that REA would remain indefinitely in the capital starved condition it was in when the notes were issued (124a-125a).

No one knows what the 1959 Commission would have done had it made the investigation mandated by 20a(2). All we can be certain of is that the 1975 Commission construes 20a(2) as imposing no more of a burden on the Commission than to rubber stamp what carrier owners find desirable in their own interest. This construction cannot be squared with this Court's opinions.

In *Denver & R.G.W. R. Co.* v. *United States,* 387 U.S. 485 (1967), a case arising out of an attempted sale of REA stock to the Greyhound Bus Company, the Commission and all three opinions filed by the members of this Court agreed that 20a(2) was intended to protect *the public* from a carrier's "fiscal manipulation." Yet the Commission and the Court below interpreted it here as meant only to make sure that notes issued by a carrier to its owners were supported by a pre-existing debt shown on its books. The adverse effect of this treatment of its capital debt on REA's ability to serve the public was not considered by the Commission in 1959 or 1975. The reviewing Court's assumption that REA benefitted from converting the bookkeeping debt to its owners for invested capital, into 14-year, 5% notes, ignored the resulting injury to REA's ability to survive.

The public had an interest in REA's survival that was different from that of REA's stockholders. Absent the note issue, REA's stockholders would have had to depend on REA's net earnings to recover their

investment. The notes enabled them to take thirteen million dollars out of REA's gross earnings during 1961-1970, a period when it lost more than four times as much as it earned. The 1961-1970 annual reports to the Commission which detailed these results were drawn to the attention of the Court below, which chose to ignore them in favor of the fact that REA made money in 1974. Both the Commission and the Court seemed to think that fact foreclosed any possibility that the thirteen million paid on the notes before they were defaulted in 1971, and REA's inability to pay off any part of the 27 million dollar principal, had contributed to its 1975 insolvency (32a).

The decision below so patently contradicts the construction of 20a(2) and its relation to the Clayton Act in *Denver & Rio Grande, supra,* that reversal is required, unless this Court is prepared to abandon the principles there announced.[7] The more recent case of *Gulf State Utilities* v. *FPC,* 411 U.S. 747 (1973), specifically applied the principle that a public interest judgment could not be made without consideration of anti-competitive factors, to the issuance of public utility securities. 411 U.S. 747, 760-62. While the dis-

[7] The Commission argued in this Court that no power exists under § 20a(2) to immunize conduct that violates the anti-trust laws. 387 U.S. 485, 496. However, the Commission found in denying REA's petition for reconsideration that it had immunized the railroads from anti-trust liability both by its 20a(2) order approving the note issue (97a-99a) and its Section 5(1) order approving the 1959 pooling agreement (308 ICC 545), (109a). The Commission's view that 20a(2) is a device for immunizing carrier stockholders from the strictures of Section 10 instead of enforcing Section 10's policy is consistent with its argument that anti-competitive considerations should play no part in a 20a(2) proceeding but is directly contrary to this Court's holdings noted above.

senting opinion in that case would give a narrower construction to § 204 of the Federal Power Act than to § 20a(2) of the Commerce Act, the dissent does not suggest that a public interest judgment required by § 20a(2) could ignore anti-competitive conduct proscribed by § 10 of the Clayton Act, in issuing carrier securities.

C. This Court's Definition of Creditors' Equitable Rights Requires a Return of the 1960-71 Interest by the Railroads to REA's Trustee.

The Court below and the Commission have approved self-dealing that was meant to defraud REA's general creditors. Under any view of the facts, the bookkeeping debt converted into the 1959 notes took the place of capital surplus. As such it was subordinate to REA's general obligations. However, the decision below rationalized its conversion into fourteen-year, unsubordinated notes as beneficent because it deferred collection of the stockholders capital claims (32a). Completely overlooked was the obvious disadvantage to REA's creditors in the bankruptcy that the note issue helped to precipitate.

When the notes were issued, REA's directors knew that liquidation was an imminent possibility and that REA's Vice President for Finance had recommended that the note issue be subordinated (120a-121a). They could not have been unaware of existing case law that attempts to place claims for capital contributions on a par with general creditors would be regarded as a fraud on other creditors. *In re Hawkeye Oil Co.*, 19 F.2d 151 (D.C.D.Del. 1927), and *United States & Mexican Oil Co.* v. *Keystone Auto Gas & Oil Service Co.*, 19 F.2d 624 (D.C.W.D.Pa. 1924).

Moreover, in 1948 litigation involving federal taxes, the Second Circuit Court of Appeals had told REA's

railroad stockholders that by using a separate corporate form for their express operations, they had barred themselves from treating REA's income as their own. *Railway Express Agency, Inc.* v. *Comm. of Internal Rev.*, 169 F.2d 193, 196 (1948). Yet by doing just that, the railroads had extracted from REA's earnings during 1930-1958, approximately $28 million as interest (131a) on its roughly equivalent capital debt to themselves, with no Commission disapproval. Fourteen more years of such interest payments would apparently give the Commission no trouble and it didn't.

This conversion sailed through the Commission in 1959 without investigation and received its blessing again in 1975, after a two-year investigation, without consideration of the notes' impact on creditors' claims in REA's 1975 bankruptcy. The Court below gave no consideration to their impact because it seemed to think that REA's 1974 earnings insulated its 1975 bankruptcy from its 1973 default on the notes. The Court seemed unable to grasp the fact that 1974 earnings of less than 3 million dollars could not discharge a defaulted debt that amounted in that year to nearly $30 million.

Creditors' rights were also ignored below in favor of a mistaken assumption that invalidation of the notes would mean a "windfall" for the stockholders who bought REA from the railroads (31a). The truth is that invalidation would benefit only REA's creditors, many of whom are employees who spent most of their working lives serving the railroad stockholders at a level where they had no role in the 1959 "fiscal manipulation" that contributed to REA's ultimate demise. They have pre-filing claims of more than $11 million with no present prospect of any payment. Suggesting

to these employee creditors that the railroads should not be held accountable for the disastrous consequences of the 1959 note issue because REA earned money in 1974 can only destroy whatever respect they may still have for what purports to be carrier regulation in the public interest. In placing their claims for a return of their capital on a par with employee claims, REA's railroad stockholders overrode even the views of REA's Vice President for Finance. Although C. J. Jump recommended that the notes be generally subordinated (120a-121a), when issued they were not.

There are also over 400 REA pensioners who retired before 1964 and whose benefits were not funded. Their pensions were cut off when REA filed its Bankruptcy petition and they are presently owed about $1½ million. They also have no present prospect of any payment of those pensions.

The railroads were not bound to fund their pensions because these pensioners retired before funding became legally obligatory. But the railroads were bound to refrain from the illegal funding of their own capital debt that contributed to REA's bankruptcy. They collected more than thirteen million in interest on their illegal notes during 1960-1971 and mere subordination of the principal would not remedy these unjust exactions. The Trustee is equitably entitled to the return of this money by the railroads, for the benefit of REA's other creditors.

The decision below did not even notice this Court's definition of a bankruptcy trustee's rights in *Pepper* v. *Litton,* 308 U.S. 295 (1939).

> "A director is a fiduciary, Twin-Lick Oil Co. v. Marbury, 91 U.S. 587, 588. So is a dominant or controlling stockholder or group of stockholders.

> Southern Pacific Co. v. Bogert, 250 U.S. 483, 492. Their powers are powers in trust. See Jackson v. Ludeling, 21 Wall. 616, 624. Their dealings with the corporation are subject to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged, the burden is on the director or stockholder not only to prove the good faith of the transaction but also show its inherent fairness from the viewpoint of the corporation and those interested therein. Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 599. The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arms length bargain. If it does not, equity will set it aside. *While normally the fiduciary obligation is enforceable directly by the corporation, or through a stockholder's derivative action, it is, in the event of bankruptcy of the corporation, enforceable by the trustee. For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation, creditors as well as stockholders."* *Pepper* v. *Litton,* 308 U.S. 295, 306-307 (emphasis ours).

The opinion below has designed a contrary standard; that bargains made with a carrier by its stockholders for their benefit are immune from creditor attack unless some stockholder having no self-interest in objecting, objects.

The decision below is by the Second Circuit Court of Appeals. That Circuit's decisions control transactions in the principal financial center of the United States. The decision may therefore result in substantial harm to creditor interests generally, if not reversed by this Court. It should be reversed because there is no rational basis for giving creditors of a corporate common carrier less protection against the abuse of fiduciary

relationships than other corporate creditors are accorded.

CONCLUSION

As the Court below correctly points out, "review of a 20a order after the parties have acted upon it presents peculiar difficulties" (32a). But the securities here involved were made non-negotiable when issued. No one but the railroads who unlawfully procured their issuance to themselves could be injured by a holding that the 1959 notes should not have been issued. They also joined in the Commission's 1975 review of its 1959 order and in the review of the Commission's decision by the Court below. They are therefore estopped to complain of the ultimate result. If the five years so far spent in litigating the validity of that order could not produce an ultimate result adverse to the litigating railroads, the entire review proceedings would be a futile exercise.

We respectfully submit that this Court should review and reverse the decision below.

Respectfully submitted,

ROBERT L. WRIGHT
1750 New York Ave., N.W.
Washington, D. C. 20006

ARTHUR M. WISEHART
150 E. 42nd St.
New York, N. Y. 10017

Attorneys for C. Orvis Sowerwine, Trustee in Bankruptcy of REA Express, Inc., a Bankrupt.

WISEHART, FRIOU & KOCH
150 E. 42nd St.
New York, N. Y. 10017

Of Counsel

APPENDIX

APPENDIX

Table of Contents

Page

Opinion of Court Below 1a-34a

Order in Accordance with Opinion 35a-36a

Notice of Appeal 37a

Order Authorizing Appeal 38a

Application for Order Authorizing Appeal 39a-40a

Interstate Commerce Commission Opinion of July 28, 1975 in Finance Docket No. 20812, Railway Express Agency, Inc. Notes 41a-96a

Commission Order of September 25, 1959 Approving Note Issue 97a-99a

Court Order Allowing Commission Intervention..100a-102a

Commission Order of January 9, 1973 Reopening Order of September 25, 1959 for Reconsideration ..102a-106a

Commission Order of July 28, 1975 Discontinuing 1973 Proceeding 107a

Commission Order of February 11, 1976 Denying Petition for Reconsideration 108a-110a

Summary of Terms of Lehman Brothers Offer to Purchase REA 111a-113a

Letter from Southern Railway Vice President to REA President dated May 1, 1959 Discussing Lehman Brothers Offer 114a-118a

Letter dated July 31, 1959 from REA Vice President, Administration and Finance, to Chairman, Finance Committee, Pennsylvania Railroad Regarding 1959 Note Issue 119a-121a

Excerpt from Sworn Statement of L. John Eichner on Behalf of REA 121a-130a

Attachment Referred to at Page 130a of Eichner Statement, Showing REA Interest Expense, 1929-1959, on Bonds and Notes and on Advances 131a

APPENDIX

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

Docket No. 71 Civ. 4278

REA EXPRESS, INC., *Plaintiff*,

v.

ALABAMA GREAT SOUTHERN RAILROAD COMPANY, ET AL., and THE UNITED STATES OF AMERICA, *Defendants*.

INTERSTATE COMMERCE COMMISSION, *Intervenor*.

Before FRIENDLY, Circuit Judge, and KNAPP and GRIESA, District Judges.

Robert L. Wright, Esq., Washington, D.C. (Arthur M. Wiseheart, Esq., and Wiseheart, Friou & Koch, Esqs., New York, N.Y., of Counsel), for Plaintiff.

Edward M. Zimmerman, Esq., Washington, D.C. (S. William Livingston, Jr., Esq., and Covington & Burling, Esqs., Washington, D.C.; and Frank H. Gordon, Esq., and Rogers, Hope & Hills, Esqs., New York, N.Y., of Counsel), for Defendant Alabama Great Southern Railroad Company, et al.

Carl E. Newton, Esq., New York, N.Y. (Thomas J. Ahlf, Esq., John W. Wall, Esq., and Donovan Leisure Newton & Irvine, Esqs., New York, N.Y., of Counsel), for Defendants The Chesapeake & Ohio Railway Company, The Baltimore and Ohio Railroad Company, and Western Maryland Railway Company.

Peter M. Shannon, Jr., Esq., Washington, D. C. (Arthur J. Cerra, General Counsel, and Peter A. Fitzpatrick, Acting Associate General Counsel, Interstate Commerce Commission, of Counsel), for Intervenor.

Thomas E. Kauper, Assistant Attorney General, Carl D. Lawson, Esq., and Catherine G. O'Sullivan, Esq., Department of Justice, Washington, D.C., for United States of America (on the brief).

FRIENDLY, Circuit Judge:

REA Express, Inc. (REA) here is both suing its former railroad owners and other holders of REA notes issued in 1959 and seeking the invalidation of Interstate Commerce Commission action taken in connection with those REA obligations. The complaint and the petition for review center upon the issuance of the 1959 notes and the creation of their antecedent, the so-called "non-negotiable debt," raising claims under section 10 of the Clayton Act, 15 U.S.C. § 20, section 1 of the Sherman Act, 15 U.S.C. § 1, sections 5(1) and 20a of the Interstate Commerce Act, 49 U.S.C. §§ 5(1) & 20a, and state fiduciary duty and contract law.

I. The Facts and the Proceedings

Since the facts of REA's corporate life are set out at length in several of the sources cited below, our exposition can be confined to outlining the background of the present controversy over the 1959 notes and the non-negotiable debt.

REA was formed in late 1928 and early 1929 as a railroad non-profit joint venture to engage in the railway express business. The new corporation's initial 1,000 shares of common stock were to be sold to certain "participating" railroads in proportion to their 1923-26 express business. "Standard Express Operating Agreements" (SEOA's) which were executed by REA and all the railroads, including the "short line" non-shareholder roads, governed the REA—railroad relationship. These agreements provided that REA would be the exclusive express agency of the railroads and that REA's revenues, after the deduction of various operating expenses, would be distributed as "Rail Transportation Revenue" to the railroad signatories in proportion to their provision of services to the express company.

To finance its acquisition of the assets of the existing express company and to obtain working capital, REA was to sell $32 million of 5% bonds. The indenture called for semi-annual sinking fund payments of $800,000 over the 20-year term of the bonds. The original 1929 SEOA provided in Article V(4)(j) for an account #409, "Surplus Applied to Sinking and other Reserve Funds;" moneys deposited in that account as sinking fund payments would be treated as REA expenses and therefore deducted from REA revenues prior to the computation of "rail transportation revenue" and distribution of this to the railroads.

In December 1928, application was made to the Interstate Commerce Commission for approval of these railroad plans for an express company. Approval of the "pooling" provisions of the SEOA was sought under § 5(1); of the railroads' control of REA under § 5(2); and of REA's issuance of the common stock and the bonds under § 20a. On February 11, 1929, ICC approval was granted. *Securities and Acquisition of Control of Railway Express Agency, Inc.*, 150 I.C.C. 423 (1929).

By resolution of April 11, 1929, the REA board of directors adopted a different arrangement for funding the sinking fund. That resolution provided for semi-annual deductions of $800 per share of REA stock from the rail transportation revenues owed the shareholding railroads and a corresponding credit to those roads in an REA account entitled "non-negotiable debt to affiliated companies —advances." The reason for the change, as explained in the recent report of the Commission, *Railway Express Agency, Inc., Notes*, 348 I.C.C. 157, 170-73, 178-79 (1975), was that the original method would have resulted in railroads whose services were disproportionately higher than their stock-holdings (including all the short lines) building up the equity of the stockholders through sinking fund

payments. The resolution provided for annual interest of 5¼% on the debt.

In 1939, the outstanding 1929 bonds were refinanced at lower interest with notes also requiring semi-annual $800,000 installments to be paid again through shareholder railroad advances treated as further non-negotiable debt with an interest rate of up to 5% as set by the REA board. The note issue was approved by the Commission under § 20a in F.D. No. 12242, *Railway Express Agency, Inc., Notes*, 230 I.C.C. 478 (1938). The Commission's Director of Finance advised that there was no need to obtain § 20a approval of the non-negotiable debt.

In 1959, dissatisfaction with the profitability of the express business led to the substitution of a new agreement for the 1954 SEOA, which had replaced the original 1929 SEOA. The new agreement sought to improve REA's efficiency through the gradual ending of its nonprofit status. As part of this rethinking of the REA—railroad relationship, it was deemed desirable for REA to issue notes to the railroad shareholders in replacement of the non-negotiable debt. Unlike the non-negotiable debt, which was wholly subordinated to other creditors, the notes were subordinated only to certain existing REA fixed debt.[1]

ICC approval of the 1959 SEOA's "pooling" provision was sought and an application for § 20a approval of the note issue was filed. The Commission approved the "pooling" provision on September 21, 1959. *Express Contract, 1959*, 308 I.C.C. 545 (1959). The issuance by REA of 5% notes to its shareholders was approved under § 20a by order of September 25, 1959 in Finance Docket No. 20812.

[1] By order of August 9, 1961 in F. D. 20812, the ICC authorized the further subordination of the notes to REA loans for terminal construction and equipment acquisition. Certain REA-railroad agreements implementing this authorization additionally provided for the subordination of the notes to "indebtedness or obligations of REA incurred in the future if the Board of Directors of REA, when authorizing such indebtedness or obligations, adopts a resolution declaring such subordination."

In the following years, several unsuccessful attempts were made to sell the railroads' REA stock. To facilitate such a sale, the majority of the stock was deposited in a voting trust in 1968 and it was agreed that the 1959 SEOA would be terminated at the end of the year; "Carrier's Agreements" terminating the SEOA provided for the post-1968 REA-railroad relationship. In June 1969, five REA executive officers who were part of a new management team assembled by February 1969 offered to purchase the REA stock through their REA Holding Corporation for over $2 million and warrants in the holding company. The deal was consummated in August 1969.

On September 30, 1971, REA filed a five-count complaint in this court attacking the notes and the non-negotiable debt. Count I alleged that the railroads violated § 10 of the Clayton Act in causing REA to create the non-negotiable debt in 1929 and again in 1938, to repay part of that debt prior to 1938 and to replace the debt with the notes in 1959. The second count charged that both the non-negotiable debt and the notes were void under § 20a(11) of the Interstate Commerce Act: the debt because it was "securities" within § 20a(2) of the Act but never approved under that section by the Commission, and the notes because the Commission's 1959 § 20a approval was conditioned on the continued operation of the 1959 SEOA which had been terminated in 1968. The absence of ICC approval of the debt also formed the basis of a third count contending that the notes were void despite their § 20a approval because the invalidity of the debt meant that the notes had been issued without consideration. The 1968 termination of the 1959 SEOA also served to support the claim in Count IV that the termination destroyed a condition of the notes. A fifth count charged that the conduct alleged in the prior counts constituted a breach of fiduciary

duty by the REA board caused by the railroad defendants. The complaint sought damages under several of the counts as well as a declaration that the debt and the notes were void.

Three of the railroad defendants moved on February 18, 1972 to dismiss the complaint for lack of jurisdiction on the ground that it amounted to an attack upon the validity of ICC orders so as to require a three-judge court under the Urgent Deficiencies Act, 28 U.S.C. §§ 2321-25. Judge Metzner granted the motion in part in a decision of June 5, 1972, holding that two of REA's claims—that the issuance of the notes violated § 10 of the Clayton Act and that the notes were unenforceable because the debt had never been approved by the ICC under § 20a—"directly attack a valid and subsisting ICC order—the order of September 25, 1959, approving the notes." *REA Express, Inc.* v. *Alabama Great Southern Railroad*, 343 F.Supp. 851, 859 (S.D.N.Y. 1972).

In an order of December 5, 1972, Judge Knapp, to whom the case had been assigned, granted REA leave to serve a second complaint. That complaint alleged jurisdiction under the Urgent Deficiencies Act, added the United States as a defendant, and included a new count alleging that the April 11, 1929 resolution of the REA board constituted price-fixing in violation of § 1 of the Sherman Act. On a motion by the defendants who had not joined in the original motion decided by Judge Metzner, Judge Knapp also dismissed for lack of single-judge court jurisdiction the same portions of the complaint dismissed by Judge Metzner, stating that the new motion "seeks to place the bulk of the defendants in the same position as the three prior movants so far as the allocation of jurisdiction between a one-judge and a three-judge court is concerned." Judge Knapp then requested the convocation of a three-judge court. Such a court was designated on December 6, 1972, to consist of the writer, District Judge Knapp and District Judge Griesa.

On December 20, 1972, the three-judge court granted motions by the ICC to intervene in REA's suit and to stay further judicial proceedings pending the Commission's reopening of its F.D. No. 20812 for reconsideration of the 1959 § 20a approval of the notes. The Commission had voted to reopen the docket on August 10, 1972. On January 9, 1973, the Commission ordered the reopening. A motion by REA to vacate the stay and to enjoin the ICC order of reopening was denied on January 23, 1973. An appeal to the Supreme Court was unsuccessful. *REA Express, Inc.* v. *Alabama Great Southern Railroad*, 412 U.S. 934 (1973).

On April 28, 1975, prior to the completion of the ICC proceeding, the defendant railroads moved for summary judgment dismissing the amended complaint. That motion relied on the Supreme Court's decision in *Bangor Punta Operations, Inc.* v. *Bangor & Aroostock Railroad*, 417 U.S. 703 (1974), on the theory that all the conduct challenged in the complaint occurred before the transfer of ownership from the defendants to REA's new owners. On the same date, REA requested an order requiring the ICC to issue a final determination or, alternatively, to treat the 1973 report of an ICC administrative law judge as the Commission's final decision. At the argument on these motions before this three-judge court on June 18, 1975, representations were made that a decision by the ICC would follow shortly; in consequence no decision on REA's motions was made. We likewise deferred ruling on the railroads' *Bangor Punta* motion, primarily because we believed that REA's insolvency[2] raised questions under footnote 15 to

[2] On February 18, 1975, REA filed a petition under Chapter XI of the Bankruptcy Act and was granted debtor-in-possession status. The bankruptcy court entered an order on March 21, 1975, permitting the litigation to continue. REA was adjudicated a bankrupt on November 6, 1975. By order of April 8, 1976, Bankruptcy Judge Galgay authorized REA's trustee to seek the setting aside of the ICC approval of the notes, the repayment of amounts already paid on them and other relief.

Mr. Justice Powell's opinion, 417 U.S. at 718 n.15, which might be more debatable than a decision on the merits would be, at least if the Commission were to revalidate its 1959 order.

On August 29, 1975, the Commission served a "Report of the Commission on Further Consideration" in *Railway Express Agency, Inc., Notes,* F.D. No. 20812, 348 I.C.C. 157, and ordered that its 1973 order of reopening be vacated and the proceedings discontinued. The report concluded that its September 25, 1959 order approving the 1959 notes had been correctly issued. The Commission found that the non-negotiable debt was in fact "debt" and not equity as its General Counsel's office apparently had thought at one point. In addition, the ICC rejected REA's claim that its 1959 § 20a order was erroneous because the notes lacked consideration, the non-negotiable debt allegedly being void for lack of approval under § 20a; the Commission held that the debt was not within § 20a. As to REA's claim of a violation of § 10 of the Clayton Act in the issuance of the 1959 notes, the ICC held that its § 5(1) order of September 21, 1959 exempted the notes from the antitrust laws pursuant to the express immunity provision of the Interstate Commerce Act, § 5(11). The Commission refrained from stating a conclusion on the status of the non-negotiable debt under § 5(11) and on several other railroad positions.

On February 11, 1976, the ICC denied REA's petition for reconsideration of its report. REA filed petitions for review of "Orders of the Interstate Commerce Commission in Finance Docket No. 20812" in the District Court for the Southern District of New York and the Court of Appeals for the Second Circuit on April 8, 1976. The railroads were granted leave to intervene in the Court of Appeals on May 10, 1976. The petitions for review contain two claims of ICC error. First, REA claims that the notes were issued without consideration because the non-negotiable debt was created in violation of § 10 of the Clayton Act. Second,

REA asserts that the Commission erred in approving the notes under the standards of § 20a and in its recent conclusion that the original approval was proper, emphasizing the alleged causal relation between the note issue and REA's subsequent bankruptcy. The petitions ask that the 1959 § 20a order be set aside, that the notes be declared void and that the noteholders be ordered to deliver into the bankruptcy court all payments collected on the notes.

Since it was debatable whether the Commission's recent action was reviewable in the Court of Appeals for the Second Circuit under P.L. 93-584, 88 Stat. 1917, amending 28 U.S.C. §§ 2321-25, or in the three-judge district court as part of its review of the 1959 order, the Chief Judge of the Second Circuit, on May 7, 1976, designated the writer, Judge Knapp and Judge Griesa as a panel of the Court of Appeals to hear REA's petition for review in that court. Accordingly we need not determine which court had jurisdiction although we incline to the view that jurisdiction remained in the three-judge district court[3] both because we doubt that the August 29, 1975, report was an order and because of the provision of § 10 of P.L. 93-584 that pending three-judge court actions "shall not be affected . . . but shall proceed to final disposition under the law existing on the date they were commenced." On June 1, 1976, the railroads filed supplemental motions for summary judgment relying on several non-*Bangor Punta* grounds for the dismissal of REA's complaint. We heard argument on September 24, 1976. The briefs and argument have made it apparent that the claims with respect to the various ICC orders, reviewable only by a statutory three-judge court (or perhaps in the case of the 1975 report by us as a panel of the Court of Appeals) are inextricably intertwined with issues determinable by the single district

[3] A decision denying the petition for review for the reasons set forth in this opinion is being filed in the Court of Appeals for the Second Circuit.

judge to whom the action was referred. Since we are of one mind as to the proper decision, we shall follow the example of *Swift & Co.* v. *Wickham*, 230 F. Supp. 398, 410 (S.D.N.Y. 1964), *appeal dismissed for want of jurisdiction*, 382 U.S. 111 (1965), *aff'd*, 364 F.2d 241 (2 Cir. 1966), *cert. denied*, 385 U.S. 1036 (1967), and dispose of the issues not requiring the presence of three judges as a non-statutory three judge district court. He, as there, if the REA trustee desires to appeal and is authorized to do so by the bankruptcy court, he can protect himself by appealing both to the Supreme Court and to the Court of Appeals.

In the light of our conclusions on the merits we find it unnecessary to consider the question, not raised in any pleading or briefed or argued by the parties, how far, if at all, the decisions of Chief Judge Jones of the District Court for the District of Columbia in *REA Express, Inc.* v. *Travelers Ins. Co.*, 406 F. Supp. 1389 (D.D.C. 1976), and of Judge Becker of the District Court for the Eastern District of Pennsylvania in *In re REA Express, Inc., Private Treble Damage Antitrust Litigation*, 412 F. Supp. 1239 (E.D. Pa. 1976), constitute a collateral estoppel against REA. We likewise find it unnecessary to rule on the railroads' *Bangor Punta* motion or to consider many serious arguments of the railroads, particularly those based upon the statute of limitations and the antitrust immunity provision of § 5(11) of the Interstate Commerce Act, when read in the light of *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363 (1973). In the interest of avoiding undue length this opinion also does not refer to still other arguments of the United States, the Interstate Commerce Commission, and the railroads that would require consideration if we had not found sufficient reason to reject REA's contentions on the grounds herein stated. Our failure to discuss these arguments in no way indicates disagreement with them.

II. The Non-Negotiable Debt

We find it convenient to break our discussion of REA's complaints into three major headings. We shall deal in this section with attacks relating solely to the non-negotiable debt, in section III with attacks relating solely to the 1959 notes, and in Section IV with the claim of breach of fiduciary obligation which relates to both. We do not mean, however, to imply that success in the attacks on the non-negotiable debt, which was retired in 1959, would inevitably produce any ultimate result favorable to REA; we simply find it unnecessary to address that question. As noted above, our discussion will encompass both REA's attacks on the ICC's orders and its claims for damages and other relief against the railroads.

A. Section 20a of the Interstate Commerce Act

The attack on the non-negotiable debt most speedily answered is that is was void for lack of approval under § 20a of the Interstate Commerce Act, which was enacted as part of the Transportation Act, 1920. Section 20a(2) provides in pertinent part:

> It shall be unlawful for any carrier to issue any share of capital stock or any bond or other evidence of interest in or indebtedness of the carrier (hereinafter in this section collectively termed "securities") or to assume any obligation or liability as lessor, lessee, guarantor, indorser, surety, or otherwise, in respect of the securities of any other person, natural or artificial, even though permitted by the authority creating the carrier corporation, unless and until, and then only to the extent that, upon application by the carrier, and after investigation by the commission of the purposes and uses of the proposed issue and the proceeds thereof, or of the proposed assumption of obligation or liability in respect of the securities of any other person, natural or artificial, the commission by order authorizes such issue or assumption. The commission shall make such order only if it finds that such issue or

assumption: (a) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose. . . .

Section 20a(11) provides in relevant part:

> Any security issued or any obligation or liability assumed by a carrier, for which under the provisions of this section the authorization of the commission is required, shall be void, if issued or assumed without such authorization therefor having first been obtained, or if issued or assumed contrary to any term or condition of such order of authorization as modified by any order supplemental thereto entered prior to such issuance or assumption; but no security issued or obligation or liability assumed in accordance with all the terms and conditions of such an order of authorization therefor as modified by any order supplemental thereto entered prior to such issuance or assumption, shall be rendered void because of failure to comply with any provision of this section relating to procedure and other matters preceding the entry of such order of authorization. If any security so made void or any security in respect to which the assumption of obligation or liability is so made void, is acquired by any person for value and in good faith and without notice that the issue or assumption is void, such person may in a suit or action in any court of competent jurisdiction hold jointly and severally liable for the full amount of the damage sustained by him in respect thereof, the carrier which issued the security so made void, or assumed the obligation or liability so made void, and its directors, officers, attorneys, and other agents, who participated in any way in the authorizing, issuing, hypothecating, or selling of the security so made void or in the authorizing of the assumption of the obligation or liability so made void. In case any security so made void was directly acquired from the carrier issuing it the holder

> may at his option rescind the transaction and upon the surrender of the security recover the consideration given therefor.

While non-negotiable debt representing an advance from an owner may fall within the letter of the term "other evidence of . . . indebtedness," one would not normally speak of a carrier's "issuing" such debt. At best, therefore, the applicability of § 20a to the contracting of the non-negotiable debt would be doubtful. Any doubts, however, are resolved by the long-standing construction given to the statute by the Commission. In *Lehigh Valley R.R. Co. Conditional Sale Contract*, 233 I.C.C. 359, 362 (1939), the Commission rejected a contention that a conditional sale contract was a security under § 20a and, applying the rule of *ejusdem generis*, construed § 20a as being "restricted to evidences of interest in or indebtedness of a carrier that are similar to or in the nature of stocks, bonds and notes." The Commission went on to indicate that obligations which have "none of the attributes of negotiability, and will not be issued or uttered" were not within § 20a(2). *Id.* at 365. It has specifically held that advances and open account debt are not covered by § 20a. *Operation of Line by Condon, Kinzua & Southern R.R.*, 145 I.C.C. 427, 429 (1928); *Duluth, South Shore & Atlantic Ry. Co. Trustees' Certificate*, 249 I.C.C. 393 (1941); *Bruce Motor Freight, Inc., Control and Merger*, 87 M.C.C. 436, 439 (1961); 73 I.C.C. Ann. Rep. 170 (1959). In 1971 the Commission instituted a rule-making proceeding to consider whether it should revise its definition of "securities" so as, *inter alia*, to include advances. However, the Commission made it clear that these had previously been regarded as outside the scope of § 20a, *Expanded Definition of Term "Securities,"* 340 I.C.C. 817, 825 (1972); 344 I.C.C. 114, 119-36, 146 (1973), and that any expanded definition would not be given retroactive application. In fact no new rule became effective. In addition to these general considerations we have here the 1938 opinion, noted above, of the Commission's Director of

Finance that no § 20a approval was required for the arrangements among the railroads to finance the sinking fund of the 1939 notes by deductions from transportation revenues payable to the stockholders and the corresponding creation of non-negotiable debt, and the Commission's recent holding that the non-negotiable debt did not require approval under § 20a, 348 I.C.C. at 206-09.

Granted that the Supreme Court's decisions on the degree of deference to be accorded an administrative agency's definition of terms in the statute which it administers may not be wholly consistent, *see Pittston Stevedoring Corp.* v. *Dellaventura*, —— F.2d ——, —— (2 Cir. 1976), slip opinions 4679, 4704-06; 4 Davis, Administrative Law Treatise, § 30.01-09 (1958) and corresponding sections in 1970 and 1976 Supplements, this is a case par excellence for accepting the agency's interpretation. *Compare New York, Chicago & St. Louis Railroad* v. *Frank*, 314 U.S. 360, 372 (1941). The Commission's construction, while perhaps not inevitable, has support in reason, has been consistent and long continued and has been relied on by the carriers to such an extent that the Commission itself has recognized that any expanded definition could not in justice be retroactively applied. It would be extraordinary indeed if the Commission or a court were now to hold that the non-negotiable indebtedness was void for lack of approval under § 20a when an application for such approval would have been dismissed for lack of jurisdiction and the Commission's Director of Finance had told REA not to seek it.

B. Section 10 of the Clayton Act

The foregoing analysis largely answers REA's claims that the incurring of the non-negotiable debt without competitive bidding violated § 10 of the Clayton Act. This provides in relevant part:

> No common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of

> commerce, or shall make or have any contracts for construction or maintenance of any kind, to the amount of more than $50,000, in the aggregate, in any one year, with another corporation, firm, partnership, or association when the said common carrier shall have upon its board of directors or as its president, manager, or as its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such other corporation, firm, partnership, or association, unless and except such purchases shall be made from, or such dealings shall be with, the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission.

Reserving the bulk of our discussion of § 10 for the 1959 notes, we think that as regards the non-negotiable debt, it is a sufficient answer that in 1914 when § 10 was enacted, no one would have considered non-negotiable debt representing advances from the owners of a carrier to be "securities" or "articles of commerce." The term "securities," used in § 10 of the Clayton Act, is more restrictive than the words "any share of capital stock or any bond or other evidence of interest in or indebtedness of the carrier" used in § 20a of the Interstate Commerce Act. If non-negotiable debt representing advances by owners is not within the latter, as we have held, it is surely not within the former. It is true that our conclusion as to the proper construction of § 20a rests in large degree on interpretation by the Interstate Commerce Commission, the agency charged with its enforcement. But the Commission is also charged with responsibilities under § 10 of the Clayton Act. It must issue regulations governing competitive bidding, receive reports of transactions within § 10 and report all violations to the Attorney General. The Commission has also recognized its responsibilities under § 10 by conditioning its approval of transactions which would violate that

section on the use of competitive bidding.[4] REA has cited no instance where the Commission has ever done this when the transaction involved the making of advances from an owning carrier with an interlock—a situation presented in the 1938 rearrangement in this very case. To the contrary the Commission has sanctioned the issuance of securities by a carrier to a parent to retire advances from the parent without intimating that the advances were within § 10.[5] It would be perverse indeed for the Commission or for us now to construe § 10, a statute carrying severe criminal penalties, to include as "securities" advances represented by non-negotiable debt. For the same reasons here developed, there is nothing in REA's argument that the partial repayment of the non-negotiable debt or its retirement in 1959 was a dealing in securities within § 10 of the Clayton Act.

C. Section 1 of the Sherman Act

REA's claim, which it did not brief, that the incurring of non-negotiable debt was a conspiracy to restrain trade or commerce because the owning railroads agreed with REA and with each other on interest rates borders on the frivolous. The agreement was between the railroads and their wholly-owned subsidiary; the interests of no other person were affected. We agree with Judge Becker, 412 F. Supp. at 1256, that "the law is plain that a wholly-owned subsidiary has no right to economic independence of all its parents acting unanimously and that no antitrust claims may be founded upon the absence of such independence." *Compare In re Penn Central Securities Litigation*, 367 F.

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[4] *See Securities of Western Pacific Railroad Co.*, 145 I.C.C. 750, 751 (1928); *Columbia Terminal Co.—Issuance of Notes*, 40 M.C.C. 288, 293-94 (1945). *See also Securities of Seaboard Air Line Railway*, 138 I.C.C. 190, 194 (1928).

[5] *Stock of St. Louis & Ohio River R.R.*, 90 I.C.C. 700 (1924); *Eldorado & Santa Fe Ry. Co Bond*, 170 I.C.C. 620 (1931); *New York & Long Branch R.R. Co. Bonds*, 252 I.C.C. 142 (1942).

Supp. 1158, 1166-67 (E.D. Pa. 1973). The contrary proposition—that agreements between parents and subsidiaries effecting only their internal relationships violate the Sherman Act—has been repudiated by the several commentators, including Justice Department officials charged with enforcing the antitrust laws. *See Report of the Attorney General's National Committee to Study the Antitrust Laws* 34 (1955);[6] *Conference on the Antitrust Laws and the Attorney General's Committee Report* 18 (1955) (statement of Edward V. Johnston); *id.* at 35-36 (statement of George E. Hale); *An Interview with the Honorable Donald F. Turner*, 34 *Antitrust L.J.* 113, 123 (1967); *Letter of Richard W. McLaren*, CCH Trade Reg. Rep. ¶ 50,122, at 55197 (1971); *ABA, Antitrust Law Developments* 33 (1975).

In addition, we are unable to perceive what damage REA suffered from the fixing of the interest rate at 5%, 5¼% or whatever rather than a lower figure. Since under the SEOA the interest was a deduction from the transportation revenue payable to the railroads, a lower interest rate would have meant correspondingly higher payments. To be sure, the shares of the railroads would have been different, but that is not REA's affair.

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[6] Reviewing the so-called "intra-enterprise conspiracy" cases, *e.g.*, *Kiefer-Stewart Co.* v. *Joseph E. Seagram & Sons*, 340 U.S. 211 (1951); *Timken Roller Bearing Co.* v. *United States*, 341 U.S. 593 (1951), the Report concluded:

> Nothing in these opinions should be interpreted as justifying the conclusion that concerted action solely between a parent and subsidiary or subsidiaries, the purpose and effect of which is not coercive restraint of the trade of strangers to the corporate family, violates Section 1. Where such concerted action restrains no trade and is designed to restrain no trade other than that of the parent and its subsidiaries, Section 1 is not violated.

See also ABA, Antitrust Developments 1955-1968 19-22 (1968) (supplementing the 1955 Report).

D. Violation of § 5(1) of the Interstate Commerce Act

A point pressed with particular vigor at the oral argument is that creation of the non-negotiable debt was never approved under § 5(1) of the Interstate Commerce Act, and that such approval was required. Although this claim does not seem to have been advanced in the complaint or petition to review, the railroads and the Commission responded at the argument and we think it best to rule upon it now rather than leaving the issue to subsequent amendment.

In relevant part, § 5(1) provides:[7]

> Except upon specific approval by order of the Commission as in this section provided, and except as provided in paragraph (16) of section 1 of this title, it shall be unlawful for any common carrier subject to this chapter. chapter 8, or chapter 12 of this title to enter into any contract, agreement, or combination with any other such common carrier or carriers for the pooling or division of traffic, or of service, or of gross or net earnings, or of any portion thereof; and in any case of an unlawful agreement for the pooling or division of traffic, service, or earnings as aforesaid each day of its continuance shall be a separate offense: *Provided,* That whenever the Commission is of opinion, after hearing upon application of any such carrier or carriers or upon its own initiative, that the pooling or division, to the extent indicated by the Commission, of their traffic, service, or gross or net earnings, or of any portion thereof, will be in the interest of better service to the public or of economy in operation, and will not unduly restrain competition, the Commission shall by order approve and authorize, if assented to by all the carriers involved, such pooling or division, under such rules and regulations, and for such consideration as between such carriers and upon such terms and conditions, as shall be found by the Commission to be just and reasonable in the premises . . . .

[7] As originally enacted in 1887, § 5 flatly prohibited the pooling of freight or revenue. Act to Regulate Commerce, 24 Stat. 380. Transportation Act, 1920, added to proviso permitting such agreements when approved by the Commission. 41 Stat. 480-81. The Transportation Act of 1940, 54 Stat. 905, generally amended the section, yielding the current § 5(1).

REA's argument runs as follows: The SEOA presented to the ICC for approval in F.D. No. 7316 in 1929 had provided that payments to the railroads should be computed in the following manner, *see* 150 I.C.C. at 439-41: Under section 4 of article V, gross transportation revenues were to be determined by taking into account four categories of income which are not here in question. From these there "shall be deducted the following charges and items of expense. . . ." One category, (j), was entitled Profit and Loss Debits. "This item shall include the following accounts:

> 409. Surplus Applied to Sinking and other Reserve Funds. . . ."

Under the SEOA as it stood when Commission approval was sought, the carriers thus were to contribute to REA's sinking fund in proportion to the transportation revenue from express traffic moving over their lines and the amounts thus contributed would have been recorded in Account 409. If this had been done, the payments to the railroads would have been less and the non-negotiable debt would never have been created. The changed method provided in the resolution of REA's board of directors dated April 11, 1929, mentioned above, whereby no charges were made to Account 409 and the sinking fund was financed by advances from the owning railroads in proportion to their stock holdings, which resulted in lower "net earnings" for REA, was never approved by the Commission and therefore violated § 5(1).

We find little in the language of the statute to compel the reading for which REA argues. Neither does there seem to be any policy reason for holding that § 5(1) required ICC approval of the sinking fund arrangement. As the

1975 Commission report details, the April 11, 1929 resolution creating the debt was designed largely to prevent maldistributions of the sinking fund burden among the railroads. *See* 348 I.C.C. at 170-73. From the point of view of the owning railroads, the resolution merely changed the form of their investment in REA from all stock to a combination of stock and debt; from REA's standpoint, although in neither case would it have been left with any surplus income of its own, the alteration left it with a debt to its owners that otherwise would have been paid off through deductions in the amounts distributed as rail transportation revenue. *See* 348 I.C.C. at 197. Since, however, REA was a non-profit corporation wholly-owned by the railroads, this difference to it had little effect on its capacity to provide express service.

Furthermore, it seems clear that the ICC has never read § 5(1) as requiring the approval of financing provisions. The Finance Docket No. 7316 application of December 18, 1928 for § 5(1) approval of the 1929 SEOA asked only that the agreement be approved "as and to the extent required by" § 5(1) and referred to the Commission's decision in *Express Contract, 1920,* 59 I.C.C. 518 (1920), in which the Commission granted § 5(1) approval to the provision in article V of the proposed standard contract between the railroads and REA's predecessor, the American Railway Express Company, for distributing the express company's earnings among the company and the railroads. The Commission there determined, although with some hesitation, to treat the plan as a § 5 "pooling," saying:

> The question at the threshold is, whether the proposed contract embodies a pooling arrangement within the purview of section 5 of the act, to the lawful consummation of which our approval is an essential prerequisite. Counsel for the railroad petitioners is of the opinion that it does; counsel for the express company takes the opposite view. We concur in the view that the plan proposed is a pooling arrangement, prescribing the division of "net proceeds of the earnings

> of such railroads" otherwise than according to individual performance. The act in terms relates to such arrangements between "competing railroads," and an ascertainment that the arrangement "will not unduly restrain competition" is one of the necessary elements of an approval by us. While primarily the provision plainly has in contemplation independently operated railroad lines competing with each other in rates and services pertaining to freight traffic, the language is broad enough to include all operations productive of railroad revenues. The lawfulness of unified express operations over all railroad lines by one express company is established by other provisions of the act, and the applicability of the pooling provision of section 5 rests finally upon the question whether in the situation there is or could be as between the railroad lines a competition which article V of the contract might unduly restrain. While counsel for those lines contends that there might be competition in point of service, it is not entirely clear that there could be competition of any character. The only rates and services here considered are those of one carrier, the express company; the statutory right of a shipper to designate the routing of his traffic and the correlative duty of a carrier to observe his instructions come into play only where "two or more through routes and through rates shall have been established" and there is "a connecting line" to which the initial carrier can make delivery pursuant to the instructions.
>
> Because of these questions, as to which there is room for doubt, and because of our views of the merits, we shall for present purposes proceed upon the assumption that article V of the contract is within the provisions of section 5 of the act.

59 I.C.C. at 521-22. However, the Commission further expressly noted the limited nature of its § 5(1) inquiry:

> With regard to the requested approval of provisions of the proposed contract, it does not rest with us to give or withhold approval further than as above under section 5 of the act. If the contract is entered into and controversies should arise between the par-

ties thereto the courts constitute the forum in which they could and should be adjudicated, and we, therefore, decline to express any opinion with regard to the particular provisions of article V or any other part of the contract.

59 I.C.C. at 523.[8]

In its 1929 decision, the Commission similarly seems to have considered the need for § 5(1) approval to be limited:

> The particular portion of the operating agreement to which our jurisdiction extends and which requires our approval under paragraph (1) of section 5 is the pooling of earnings arrangement embodied in Article V, which is given in full in Appendix B. In *Express Contract, 1920,* [59 I.C.C. 518 (1920)], we had under consideration a similar pooling arrangement which is now a part of the existing uniform express contracts. Our report in that proceeding and the action taken thereon are controlling in the instant applications. In its material terms the pooling arrangement in Article V of the proposed operating agreement is substantially the same as in that article of the uniform express contracts, any differences being due to the fact that as now constituted the Express Company is privately owned and operated for profit, while the Express Agency will be controlled by the participating railroads, and the earnings remaining after accounting for all items of income and deductions therefrom will be designated "rail transportation revenue" and paid to the carriers within specified groups that are entitled to receive it. In arriving at the amount of such revenue, provision is made under item (j) of section 4 of this article for deducting certain profit and loss debit items therein enumerated, including surplus applied to sinking funds or set aside for investment in physical property. The effect of this will be to reduce the operating revenues of the railroad carriers which they derive from express traffic by amounts

[8] This may have been occasioned by Commissioner Eastman's criticism, in dissent, of the "wrong theory" embodied in article V —"to enhance the value of the express company's securities and safeguard its financial operations." *See* 59 I.C.C. at 523-28.

> which are in reality appropriations of surplus. It should be understood that all that we are here passing upon is the plan for pooling and dividing earnings and we are not passing upon other provisions of the contract, such as that mentioned above. Nothing herein contained is to be construed as an expression of opinion upon the propriety of such deductions in connection with the determination of recapturable income under section 15a of the interstate commerce act.

150 I.C.C. at 433-34. The 1929 order was in accord:

> *It is further ordered, That* Article V of said proposed operating agreement be, and it is hereby approved and authorized solely in so far as it provides for a division of earnings for which the commission's approval and authorization is required under paragraph (1) of section 5 of the interstate commerce act.
>
> *And it is further ordered,* That nothing herein shall be construed as approving any particular provisions of Article V or of any other part of said proposed operating agreement.

150 I.C.C. at 442-43.

The Commission adhered to this position in its further consideration of article V in a 1950 proceeding under § 5(1). *Express Earnings, Plan and Method of Division,* 278 I.C.C. 505 (1950). In an earlier rate proceeding, the Commission had referred to a supplemental agreement embodying a so-called economy plan for dividing revenue from interline traffic and apparently took the view that it required separate § 5(1) approval:

> The supplemental agreement was not filed with us until after the hearing herein, and no application has been made for modification of our order setting forth the terms under which the pooling of revenues and division of earnings were authorized, and to that extent the Express Agency and carriers parties to the arrangement apparently are in violation of section 5(1) of the act, and of our order setting forth the authorized method of apportionment. The Express Agency will be expected to comply with that provision of the act.

Increased Express Rates and Charges, 1946, 266 I.C.C. 369, 380-81 (1946). The Commission, however, then decided that no § 5(1) action was required:

> Upon further consideration, we are of the opinion that the action of the Agency in adopting the economy plan without applying to us for a supplemental order was in no way unlawful. In considering the present arrangement, as well as its predecessor in 1920, we pointed out specifically that we were approving only the general plan for pooling and dividing earnings and were not passing upon the particular provisions of article V or any other part of the contract. *Express Contract 1920,* 59 I.C.C. 518, 523; *Railway Exp. Agency, Inc., Securities and Control,* [150 I.C.C. 423], pages 434, 442, and 443. The economy plan supplemented a particular provision of article V which related to the apportionment of revenue on shipments moving over more than one line of railroad and was not included in the approval and authorization given in the last-cited report. It appears, therefore, that no action on our part was or is now required to validate the use of the economy plan.

278 I.C.C. at 509. Similarly, in its § 5(1) approval of the 1954 SEOA, the Commission stated:

> In the proposed contract article 10 replaces article V, which has been rewritten and amplified. As at present, the railroads are classified in four groups—eastern, southern, western, and mountain-Pacific, but a change has been made in the method of dividing revenue from inter-group traffic which presumably disposes of the controversy discussed in our 1950 report before referred to. Article 10 is lengthy and includes numerous accounting matters. We see no reason for reproducing it here, since it is unnecessary that we pass upon the specific details thereof.

Express Contract, 1954, 291 I.C.C. 11, 12-13 (1953). And when it approved the 1959 SEOA under § 5(1), the Commission observed:

> Necessarily numerous details of the proposed agreement have not been discussed in this report for the reason that they are not germane to the broad issue of pooling. In prior reports the articles of the contracts dealing with the division of earnings have had principal consideration, but the Commission has deemed it unnecessary to pass upon the specific details thereof.

Express Contract, 1959, 308 I.C.C. 545, 551 (1959).[9]

Additionally, although perhaps the Commission was not there addressing the § 5(1) argument REA makes here, conclusions reached in its 1975 report support the proposition that § 5(1) was not violated by the change in the method of financing the sinking fund. The report recounts the genesis of the non-negotiable debt and the Commission's knowledge of this in 1929 and through later proceedings. Referring to the argument of its Office of General Counsel "that procedures followed by the parties in 1929 differed from, or 'were contrary to,' the procedures approved by the Commission in its 1929 order approving the operating agreement"—a point also said to be "the major argument of REA"—the Commission stated:

> We think it clear from our 1929 report that we were not requiring any specific method of accounting for the sinking fund and computing rail transportation revenues . . . .
>
> . . . From a review of our own records and the new evidence received, we are satisfied that the Commission was adequately advised of the possibility of alternate methods of accounting for the sinking fund. This appears to be reflected in our report, which we view as permitting the method finally adopted.

348 I.C.C. at 205.

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[9] In two other § 5(1) proceedings involving REA, the Commission never indicated that the sinking fund arrangement required specific § 5(1) approval. *See Express Contract, 1929,* 275 I.C.C. 739 (1951) (reaffirming § 5(1) approval following government antitrust suit); *Railway Express Agency, Inc. and Certain Railroad Carriers' Application for Authority to Contract for Pooling and Division of Earnings,* 227 I.C.C. 517 (1938) (approving addition of Southern Railway Company and affiliates).

To be sure, the Commission's view of the sweep of § 5(1) is not conclusive. But here, as in the case of § 20a, there is every reason to defer to the Commission's practice. As indicated in the extract we have quoted from *Express Contract, 1920,* 59 I.C.C. at 521-23, "the applicability of the pooling provision of section 5 rests finally upon the question whether in the situation there is or would be as between the railroad lines a competition which article V of the contract might unduly restrain." It is hard to see how the restraint would be affected by whether the sinking fund was created by proportionate deductions from transportation revenues or by advances proportionate to stock ownership.[10]

What little case law there is under § 5(1) suggests that the Commission's reasonable views on when a new § 5(1) order is required will be respected. In *Order of Railway Conductors & Brakemen* v. *United States,* 263 F. Supp. 650 (N.D. Ill. 1966), *aff'd per curiam,* 388 U.S. 455 (1967), the pooling agreement that had been submitted to the Commission by the Pullman Company and certain railroads provided for the operation of the sleeping car business. That contract permitted the railroads to request partial service from Pullman and after the Pennsylvania Railroad Company requested such service, Pullman and the Pennsylvania executed, without seeking further § 5(1) approval, an "Amendment to Uniform Service Contract" delineating those terms. The new agreement initially was enjoined and declared violative of § 5(1) subject to the Commission's approval or its determination that no additional approval was necessary. *Brogan* v. *Pennsylvania Railroad*

[10] *See also American Rail Box Car Co.—Pooling,* 347 I.C.C. 862, 882-84 (1974), where the Commission referred to its power under § 5(9) to react on its own initiative to pooling agreement changes and stated that it has required new approval only when the changes "can clearly be characterized as substantive in nature, and include entirely new service contracts or modifications in the basic policy by which pooled revenues are to be distributed."

Co., 211 F. Supp. 881 (N.D. Ill. 1962). The ICC then determined that the agreement was "fully contemplated" by and "not inconsistent" with the agreements previously submitted and did not require specific approval or violate prior orders. *Proposed Pooling of Railroad Earnings and Service Involved in Operation of the Pullman Co. under Railroad Ownership,* 322 I.C.C. 100 (1964). That decision was upheld on review, the three-judge court finding that the new agreement "was not a new or changed arrangement for pooling." 263 F. Supp. at 655.[11] *See also Mover's & Warehousemen's Association* v. *United States,* 303 F. Supp. 563, 568-69 (D.N.J. 1969) (ICC approval of acquisition prior to approval of substitution of acquiring corporation in carrier's previously-approved pooling agreement not error: "It would appear that the mere filing with the Commission of the proposed agreement should satisfy the requirements of the decision under review and we agree that it suffices for the Commission's purposes.").

III. The 1959 Notes

Two of the attacks on the validity of the 1959 notes—those under § 1 of the Sherman Act and § 10 of the Clayton Act—are similar to those on the non-negotiable debt, although the Clayton Act claim with respect to the notes cannot be disposed of, as it was in the case of the non-negotiable debt, on the ground that there was no "issuance" of "securities." Two other challenges to the notes' § 20a approval are the contention apparently initially raised by the Commission's staff that the non-negotiable debt was not true debt but rather was equity and there was

[11] Both the Commission and the reviewing court relied in part on the uniform contract's provision for "such modification as may, in the particular case, be necessary to provide reasonable and non-reasonable terms" for furnishing partial service, thus indicating that a § 5(1) approval need not be of the exact terms of the agreement.

therefore no consideration for the issuance of the notes, and REA's claim that the Commission erred in finding that their issuance complied with the terms of § 20a(2). A final claim is that the notes and their § 20a authorization were conditioned on continuation of the 1959 SEOA which was terminated in 1968.

A. Section 1 of the Sherman Act

As in the case of the non-negotiable debt, REA has taken the position in its proposed third complaint that the fixing of the 5% interest rate on the 1959 notes by agreement between the railroads and REA constituted price-fixing which is a *per se* violation of § 1 of the Sherman Act. Since this claim is closely related to the Sherman Act attack on the debt, it seems best to pass upon it now rather than leaving the point open.

On this subject we have little to add to our discussion in Section II C. If REA had been owned by only one railroad, it could scarcely be claimed that an agreement fixing the rate of interest on notes issued to retire advances on open account constituted price fixing forbidden by the antitrust laws. We see no reason for taking a different view because of the ownership of REA by a large number of railroads.

B. Section 10 of the Clayton Act

To the writer the inapplicability of § 10 of the Clayton Act to a refunding by notes of open account debt owed to the stockholders of a joint facility is clear, for reasons stated in his concurring opinion in *Klinger* v. *Baltimore & Ohio R.R. Co.*, 432 F.2d 506, 516-19 (2 Cir. 1970)—a line of reasoning followed in *Cleary* v. *Chalk*, 488 F.2d 1315 (D.C. Cir. 1973), *cert. denied*, 416 U.S. 938 (1974). However, a majority of the *Klinger* court held that a sale by one railroad to another, with which there was an interlock, of stock and notes of a jointly owned terminal subsidiary constituted a dealing in securities within the scope of § 10. Whether correct or not, the holding is distinguishable. The *Klinger* majority's conclusion that the words of § 10 were "broad enough to cover the collateral abuse of a common carrier accepting inadequate consideration from the interlocked purchaser," 452 F.2d at 510, related to a case where "the interlocked purchaser," the B&O, owned 42% of the stock of the seller, the Reading. There was thus a danger that the B&O might have overreached the Reading to the detriment of its other stockholders, an end against which the majority thought § 10 of the Clayton Act was designed to protect even on the facts there at hand. No such evil is present where owners deal uniformly with their wholly-owned subsidiary. Thus, even if § 10 reached "the collateral abuse" in *Klinger*, there is simply nothing to indicate that Congress meant that provision to cover a securities transaction between a carrier and all its owners. The "evident purpose" of the statute—"to prohibit a corporation from abusing a carrier by palming off upon it securities, supplies and other articles without competitive bidding and at excessive prices," *Minneapolis & St. Louis Railway* v. *United States*, 361 U.S. 173, 190 (1959), or in the converse case, by "buying something too cheaply," *Klinger, supra*, 432 F.2d at 512—is not at all apposite in such a transaction. After issuance of the notes REA was in no different position vis-a-vis its owners than before, except that the notes had a fixed term, certain sinking fund requirements and less severe subordination provisions. The Supreme Court has characterized § 10 of the Clayton Act as "a rather narrow prohibition applicable to activity that is conceptually within the antitrust philosophy." *United States* v. *Boston & Maine Railroad*, 380 U.S. 157, 162 (1965). It would be unduly literalistic to read that section as applying to the issuance of the 1959 notes. Ob-

viously the Commission did not consider it to be applicable; if it had thought so, it would have required competitive bidding, as the cases cited in fn. 4, *supra*, clearly indicate.[12]

C. Invalidity of the Order Under § 20a Approving Issuance of the 1959 Notes

Our previous discussion has removed most of the grounds on which REA asserts that the order of September 25, 1959 under § 20a approving the issuance of the 5% notes was invalid. Apart from the question whether there was no consideration for issuance of the notes since the non-negotiable debt constituted equity, all that is left is REA's assertion that the Commission had no sufficient basis for finding that issuance of the notes was "compatible with the public interest" and "necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier" and would not "impair its ability to perform that service." Heavy emphasis is placed on REA's present financial plight and the fact that the non-negotiable debt was subordinated to all claims of other creditors whereas the notes carried only a limited subordination.

A principal purpose for our granting a stay pending a report from the Commission was to enable it to give further consideration to these issues. In its 1975 report the Commission stated, 348 I.C.C. at 162:

> After reviewing the record in this proceeding and related proceedings, we are convinced that the Non-Negotiable Debt was clearly a "debt" of REA from the time of its creation until its discharge by the issuance of the 1959 notes. Therefore, the 1959 notes were not "incorrectly approved" by us due to lack of consideration. We have found no great difficulty in concluding that something which the parties call "debt," and consistently treat as "debt," is, in fact, "debt," and the evidence and arguments supporting our conclusion are set forth below.

[12] Indeed, in *Securities of Western Pacific R.R. Co., supra*, 145 I.C.C. at 753, the Commission approved a subsidiary's issuance of promissory notes to its parent without competitive bidding, expressly indicating that it did not consider the transaction within § 10 despite an interlock.

The Commission elaborated on this, 348 I.C.C. at 206:

> We have reviewed the treatment of the Non-Negotiable Debt over a period of 40 years by the railroads, REA, third parties, including banks, and the Commission, and we have found a practically unanimous acceptance of this instrument as a debt. The evidence in support of the "debt" characterization includes action by businessmen and bankers involving substantial sums of money, opinions by attorneys knowledgeable in the field and action or forbearance by government agencies, including the Internal Revenue Service and ourselves. (Among our own actions is our 1928 report indicating our awareness of the system of interest-bearing advances, and our 1938 order authorizing an issue of notes to be repaid through this system.) Many persons and businesses have acted in reliance upon the Non-Negotiable Debt being debt. This would include the present owners of REA who purchased it for slightly over $2 million in 1969. It was clear from the purchase negotiations and terms that sellers and buyers assumed of the 1959 notes were valid. We are certainly not basing our decision on the fact that the new owners would receive a $27 million wind-fall, but we do mention it as one not insubstantial consequence of revoking our 1959 order. From the foregoing, we conclude that the Non-Negotiable Debt is in fact, debt.

Our review of the evidence convinces us that this conclusion is amply supported.

We also reject the contention that the Commission had no sufficient basis for permitting issuance of the notes even if the non-negotiable debt was what it purported to be. REA's argument amounts to condemnation by hindsight. REA itself placed in evidence a 1959 offer by a highly responsible firm of investment bankers to purchase all of

REA's stock for $500 per share and pay off the non-negotiable debt within two years; clearly the firm considered REA to be a viable enterprise. Since the non-negotiable debt apparently was payable upon demand, its conversion into a debt maturing on December 31, 1973, with sinking fund payments to begin only in 1965, afforded a significant benefit to REA, balancing in considerable degree the change regarding subordination. Moreover, there was no reason for the railroads to continue subordination after the intended beneficiaries had been paid. REA paid interest on the notes until 1971 when it stopped such payment upon the bringing of this action. As late as 1974 REA had an operating profit of $2.8 million as compared with an annual interest charge of approximately $1.4 million on the notes. REA simply has not demonstrated a relation between the 1959 notes and its current financial plight sufficient to require a conclusion that the Commission erred either in 1959 in approving the notes or more recently in refusing to reverse that authorization.

Beyond all this, review of a § 20a order after the parties have acted upon it presents peculiar difficulties. *Cf. New York, Chicago & St. Louis Railroad* v. *Frank, supra,* 314 U.S. at 372. A prime purpose of § 20a is to protect the purchaser of railroad securities. *See Interstate Investors, Inc.* v. *United States,* 287 F. Supp. 374, 387 (S.D.N.Y. 1968), *aff'd pur curiam,* 393 U.S. 479 (1969); I. L. Sharfman, The Interstate Commerce Commission 190 (1931); III B. Schwartz, The Economic Regulation of Business and Industry 1705 (1973) (remarks of Sen. Lenroot). This objective would hardly be accomplished by holding, as REA urges, that if the Commission erred in allowing the securities to be issued, they should be held void. However, we are not obliged to rely on this consideration since we perceive no ground for invalidating the Commission's 1959 order.

D. Effect of Termination of the 1959 SEOA in 1968

Little need be said with respect to the counts of the complaint which allege that the December 31, 1968 termination of the 1959 SEOA as part of the planning leading to the sale of the REA stock to its new management in 1969 worked a discharge of the 1959 notes and that approval of the notes was conditioned upon continuation of the 1959 SEOA. Judge Metzner rejected the latter contention, 343 F. Supp. at 860, for reasons with which we agree, and REA has briefed neither point. Only the clearest language would support a claim that, by altering the SEOA as part of the events whereby REA became an independent entity, the railroads meant to discharge over $27 million of notes and leave the purchasers with a debt-reduced enterprise. We find none.

IV. Alleged Breach of Fiduciary Duty

All that remains for consideration is Count V of the amended complaint which charges that the railroads caused the REA directors to breach their fiduciary duty in creating the non-negotiable debt, in retiring it by issuing the 1959 notes, and by terminating the 1959 SEOA in 1968. Our rulings on other issues have eliminated most of these claims. What is left requires little discussion. Apart from the conceptual difficulty in finding a breach of fiduciary duty when directors take action desired by all the shareholders, *see In re REA Express, Inc., Private Treble Damage Antitrust Action, supra,* 412 F. Supp. at 1257-58, we see nothing in any of the challenged transactions that could constitute such a breach. Here again, although REA denies that it has abandoned the point, it has not developed this in its extensive briefing.

So much of this complaint as challenges the validity of orders of the Interstate Commerce Commission and the petition to review are dismissed for failure to state a claim

upon which relief can be granted; the railroads' motion for summary judgment with respect to other portions of the complaint is granted. The United States, the Interstate Commerce Commission and the railroads shall recover their costs. These shall be promptly taxed and filed in REA's bankruptcy proceedings. With respect to various motions and counterclaims which are not before us, the parties are directed to proceed expeditiously before Judge Knapp in light of this opinion, to the end that this litigation may be speedily concluded.

/s/ HENRY J. FRIENDLY
Henry J. Friendly, *C.J.*

/s/ WHITMAN KNAPP
Whitman Knapp, *D.J.*

/s/ THOMAS P. GRIESA
Thomas P. Griesa, *D.J.*

DATED: NOVEMBER 18, 1976

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Nos. 304, 403—September Term, 1976.
(Argued September 24, 1976 Decided November 18, 1976.)
Docket Nos. 75-4209, 76-4103

REA EXPRESS, INC., *Petitioner,*

v.

INTERSTATE COMMERCE COMMISSION and UNITED STATES,
Respondents.

ALABAMA GREAT SOUTHERN RAILROAD COMPANY, et al.,
Intervenors.

Before: FRIENDLY, *Circuit Judge* and KNAPP and GRIESA, *District Judges.*•

Petition under 28 U.S.C. §§ 2321 and 2342(5) to review a 1959 order of the Interstate Commerce Commission and a related 1975 report and attendant orders of the Commission.

Denied.

ROBERT L. WRIGHT, Esq., Washington, D.C. (Arthur M. Wisehart, Esq., and Wisehart, Friou & Koch, Esqs., New York, N.Y., of Counsel), *for Petitioner.*

EDWIN M. ZIMMERMAN, Esq., Washington, D.C. (S. William Livingston, Jr., Esq., and Covington & Burling, Esqs., Washington, D.C.; and Frank H. Gordon, Esq., and Rogers, Hoge & Hills, Esqs., New York, N.Y., of Counsel), *for Intervenors.*

PETER M. SHANNON, Jr., Esq., Washington, D.C. (Arthur J. Cerra, General Counsel, and Peter A. Fitzpatrick, Acting

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• Of the United States District Court for the Southern District of New York, sitting by designation.

Associate General Counsel, Interstate Commerce Commission, of Counsel), *for Respondent Interstate Commerce Commission.*

THOMAS E. KAUPER, Assistant Attorney General; Carl D. Lawson, Esq.; and Catherine G. O'Sullivan, Esq., Department of Justice, Washington, D.C., *for United States of America* (on the brief).

PER CURIAM:

This petition to review concerns an order of the Interstate Commerce Commission in F.D. 20812 made on September 25, 1959, which would have been reviewable by a three-judge district court, and a report on further consideration, served August 29, 1975, which, if an "order," might be reviewable in this court. We find it unnecessary to determine where review lies since for the reasons stated in Judge Friendly's opinion in *REA Express, Inc.* v. *Alabama Great Southern Railroad,* Civil No. 71-4278 (S.D.N.Y., filed November 18, 1976) —— F. Supp. ——, by a three-judge district court composed of the members of this panel, the petition must be denied on the merits.

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

C. ORVIS SOWERWINE, Trustee in Bankruptcy of REA Express Inc., a Bankrupt, *Plaintiff,*

v.

THE ALABAMA GREAT SOUTHERN RAILROAD COMPANY, THE INTERSTATE COMMERCE COMMISSION, THE UNITED STATES OF AMERICA, *et al., Defendants.*

Civil Action No. 71-4278

(W.K. Three-Judge Court)

Notice of Appeal to the Supreme Court of the United States

NOTICE IS HEREBY GIVEN that C. Orvis Sowerwine, the Plaintiff above-named, hereby appeals to the Supreme Court of the United States from the judgment dismissing the Complaint and affirming the Interstate Commerce Commission's decision of July 28, 1975 in Finance Docket No. 20812, entered in this action on November 18, 1976.

This appeal is taken pursuant to 28 U.S.C. § 1253.

/s/ C. ORVIS SOWERWINE
C. Orvis Sowerwine
Plaintiff, *pro se*
150 East 42nd Street
New York, New York 10017

(CERTIFICATE OF SERVICE OMITTED IN PRINTING)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

In re REA EXPRESS, INC., f/k/a Railway Express Agency, Inc., Bankrupt.

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75 B 253

Order Authorizing a Notice of Appeal to the United States Supreme Court from an Adverse Order of a Three-Judge District Court

At New York, New York, in the Southern District of New York on the 14th day of January, 1977.

Upon reading the annexed application of C. Orvis Sowerwine, Trustee, dated January 13, 1977, by Whitman & Ransom, Esqs. and Marcus & Angel, Esqs., his attorneys, and this Court having found that the appeal proposed by the Trustee would be in the best interest of the estate of the bankrupt, and no adverse interest being represented, it is

ORDERED, that the Trustee is authorized to file a notice of appeal from the decision of the three-judge Court, rendered in *REA Express Inc., a Bankrupt, Plaintiff* v. *The Alabama Great Southern Railroad Company, et al., Defendants,* Civil Action No. 71-4278 on November 16, 1976 to the United States Supreme Court and the Trustee is also authorized to perfect said appeal.

/s/ JOHN J. GALGAY
John J. Galgay
Bankruptcy Judge

(CAPTION OMITTED IN PRINTING)

75 B 253

Application for an Order Authorizing a Notice of Appeal to the United States Supreme Court from an Adverse Order of a Three-Judge District Court

TO THE HONORABLE JOHN J. GALGAY, BANKRUPTCY JUDGE:

The application of C. Orvic Sowerwine, Trustee in Bankruptcy, by his attorneys, Whitman & Ransom, Esqs., and Marcus & Angel, Esqs., respectfully alleges:

1. On April 8, 1976, an order was entered authorizing and directing the Trustee to take appropriate action for the purpose of seeking to have reviewed, set aside and declared null and void orders by the Interstate Commerce Commission in Finance Docket No. 20812, with respect to the issuance of approximately $27 Million of notes issued by the bankrupt in 1959 and interest thereon.

2. Pursuant to said order, the Trustee petitioned the three-judge District Court designated to hear the case of *REA Express, Inc., Plaintiff* v. *The Alabama Great Southern Railroad Company, et al Defendants,* to set aside the foregoing Commission Order and to declare the aforesaid notes "null and void from the date of issuance."

3. After receiving briefs and hearing oral argument, that Court held, in an opinion and judgment filed on November 16, 1976, that the Commission's decision approving said note issue was correct in all respects and that the notes are valid obligations of the bankrupt corporation.

4. As of February 18, 1975, when the above-named bankrupt filed its petition for an arrangement under Section 322 of Chapter XI of the Bankruptcy Act (if the aforesaid judicial decision is correct), the bankrupt owed as principal and interest on these notes, which had been repudiated by REA Express, Inc. in 1971, when the aforesaid suit was filed, in excess of Thirty-Two Million ($32,000,000.00) Dollars.

5. The Trustee has been advised and believes that the three-Judge Court's decision was erroneous and that instead of holding valid claims for $32 million, the note-holders may be equitably indebted to him in a sum exceeding $13 million, representing interest collected by them on these notes during 1960-1971.

6. The debtor was adjudicated a bankrupt on November 6, 1975 and the Trustee has since liquidated a substantial part of the debtor's tangible assets. As of February 18, 1975, in addition to the aforesaid claims on these notes, there were about forty million dollars in claims by other creditors. Liquidation of REA's tangible assets has not provided enough cash to make any payment on account of any of these pre-filing claims, due to substantial expenses incurred in the subsequent operation of the bankrupt's business.

7. Most of the legal fees and other costs needed to obtain a final adjudication of the validity of these notes have already been incurred by the Trustee. The time to file the notice of appeal expires on or about January 14, 1977. The Trustee needs additional time to decide whether or not to perfect said appeal. In the Trustee's opinion, the additional expense required to appeal the three-judge Court's decision to the Supreme Court is a very small fraction of the potential benefit to the bankrupt's creditors that could result from reversal of that decision.

WHEREFORE, the Trustee respectfully requests that the annexed order be signed.

Dated: New York, New York, January 13, 1977

C. ORVIS SOWERWINE, TRUSTEE
By Whitman & Ransom and
Marcus & Angel, co-counsel

/s/ By DONALD L. ILLEGIBLE
Donald L. Illigible
A Member of the Firm of
Whitman & Ransom

INTERSTATE COMMERCE COMMISSION

Finance Docket No. 20812

RAILWAY EXPRESS AGENCY, INC., NOTES

(Served August 29, 1975)

(Decided July 28, 1975)

On further consideration, held that issuance of notes to evidence funds advanced on open account, referred to as "non-negotiable debt," properly authorized in prior order (not printed), decided September 21, 1959, since non-negotiable debt was, in fact, debt.

John M. Cleary, Michael Lang, F. Douglas Rudd, and *Arthur M. Wisehart* for REA Express, Inc.

Charles B. Evans, S. William Livingston, Jr., Sidney Weinberg, and *Edwin M. Zimmerman* for certain railroads.

REPORT OF THE COMMISSION ON FURTHER CONSIDERATION

BY THE COMMISSION:

This proceeding was reopened for further consideration by order of January 9, 1973, following the entry on December 20, 1972, of an order by the United States District Court, Southern District of New York, granting a motion made by this Commission to intervene and to stay further court proceedings in a civil action entitled *REA Express, Inc.* v. *The Alabama Great Southern Company, et al.,* 71 Div. 4278. A central issue in the court action is the enforceability of certain notes issued by the Railway Express Agency, Inc (REA), the predecessor of the plaintiff in the court action, following authorization by the Commission in this proceeding (Finance Docket No. 20812). By order of September 25, 1959, (Appendix A) the Commission, Division 4, acting pursuant to section 20a of the Interstate Commerce Act, authorized REA to issue nonnegotiable promissory notes to 66 of its controlling railroads in the amount of $27,637,053.80 (1959 notes). The 1959 notes were

issued to "evidence * * * open-account indebtedness" of REA to these railroads in the same amount. We have reopened this proceeding, and the court has agreed to stay its proceeding, in order that we may consider the question whether the 1959 notes were, in fact, issued for "debt," the bearing of that question on the correctness of our 1959 order, and the relationship of the 1959 order and earlier orders to certain claims made by REA under the antitrust laws.

Scope of the Reopening

In order to understand the scope of this reopening, it is necessary to briefly describe the major events leading up to this stage in the proceeding. A more complete factual exposition is set forth below. In January 1929, substantially all the railroads in the United States entered into a joint venture to conduct the railway express business in this country. This was to be accomplished by purchasing all the assets of the sole express then operating, the American Express Company, and transferring these assets to the newly-formed REA. The assets were to be purchased with funds raised through the public sale of $32 million of 5 percent REA bonds. All the capital stock REA was sold to 85 "participating railroads" for a total amount of $100,000. Operating agreements were executed between REA and all railroads using the express service. These agreements provided that REA would be the exclusive express agency of the railroad and that annual revenues of REA, after deduction of operating costs, would be distributed to the railroads executing operating agreements in proportion to their express business. On February 11, 1929, the Commission approved these transactions, specifically authorizing the pooling of earnings, the control of REA by the railroads, the sale of the bonds, and the distribution of the capital stock, pursuant to sections 5(1), 5(2) and 20a of the Interstate Commerce Act: *Securities*

and Acquisition of Control of Ry. Exp. Agency, Inc., 150 I.C.C. 423 (1929).

In its report, the Commission stated that it was not passing on all provisions of the operating agreement such as the provision for sinking funds to repay the bonds. The record in this proceeding is replete with evidence relating to two proposed methods of providing a sinking fund for repayment of the maturing REA bonds, the motivations of the railroads in adopting one of the methods and the knowledge of the Commission of a dispute about the sinking fund at the time of the February 11, 1929, report and order was issued. This evidence will be set forth below. At the first meeting of the permanent board of REA, on April 11, 1929, it was decided to meet the sinking fund obligation on the bonds by deducting from "rail transportation revenues" payable to the stockholding railroads by REA, $800 semiannually for each share of stock held, "such deductions to be credited to such stockholders as money advanced to REA." These amounts were carried on REA's books from their inception as "non-negotiable debt to affiliated companies—Advances" (the Non-Negotiable Debt). Interest of 5.5 percent per annum was paid on the Non-Negotiable Debt.

By 1938, approximately $15,200,000 had been paid into the sinking fund, leaving $16,800,000 in 1929 bonds outstanding. $2,600,000 on the Non-Negotiable Debt had been repaid to railroads, so that the REA's books showed advances of $12,600,000 as of December 31, 1938. Because of the low interest rates prevailing in 1938, REA decided to call the outstanding bonds and issue a like amount of notes at a lower interest rate (the 1938 notes). The notes, like the bonds, would mature in semiannual installments of $800,000 and, again like the bonds, the funds for repayment would be advanced by the stockholding railroads and treated as additional Non-Negotiable Debt. The Commission, Division 4, approved the issuance notes in the principal amount

of $16 million (the amount of 1929 bonds to be outstanding on March 31, 1939) pursuant to section 20a of the Act, on December 20, 1938, in its report described the proposed repayment through advances. *Railway Exp. Agency, Inc. Notes,* 230 I.C.C. 478, 479-480 (1938).

In 1959, the railroads proposed a new operating agreement reducing the restrictions on REA's use of carriers other than rail lines and making other changes in hopes of improving REA's performance. This was motivated, in part, by increased out-of-pocket deficits sustained by the railroads for the services they provided REA, with this deficit reaching $40 million in 1958. In a report dated September 21, 1959, the Commission, Division 3, approved the new pooling agreement pursuant to section 5(1). *Express Contract, 1959,* 308 I.C.C. 545 (1959). Simultaneous with the revision of the operating agreement the railroads and REA decided to issue promissory notes to the railroads in exchange for the Non-Negotiable Debt, which then totaled $27,637,153.80. By order dated on September 25, 1959, the Commission, Division 4, authorized the issuance by REA of the 1959 notes to the railroads in an amount equal to the amount of advances to each railroad shown on REA's books. Approval noted, *Railway Express Agency, Inc., Notes,* 307 I.C.C. 812.

The earnings performance of REA did not improve and, in order to prepare for a sale of REA to outside interests, most of the shareholding railroads deposited their REA stock in a voting trust in 1968. In August 1969, five officers of a holding company, the REA Holding Corporation, which purchased virtually all the REA stock held by the railroads for approximately $2 million cash and warrants to purchase shares of the holding company. After the new owners took control of REA, interest payments on the 1959 notes continued to be made by REA until September 1971. On September 30, 1971, REA filed the civil action against the holders of the 1959 notes referred to at the beginning

of this report, *REA Express, Inc.* v. *The Alabama Great Southern Railroad Company, et al.* (REA Lawsuit).

The REA Lawsuit

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Background

At the time of the passage of the Interstate Commerce Act in 1887, there were thirteen rail express companies operating in the United States. These companies would take orders from shippers for the expedited transport of small freight packages, and perform any necessary pick up and delivery to and from a railroad, which was responsible for the actual movement of the goods. The shipper would make full payment to the express company, which would then reimburse the rail carrier for its portion of the service.

As part of the national mobilization for World War I, the railroads were put under Federal control in 1917. At that time, the railroad express business in the United States was carried on by seven companies, with the four largest (Adams, American, and Southern Express Companies, and Wells Fargo & Company) accounting for approximately 95 percent of the business. The Director General of Railroads refused to honor the contracts with the several express companies, insisting on contracting with a single entity as his express agent. Accordingly, the four largest companies acquired the businesses of the three others and exchanged the combined express properties (valued by the Director General at $30 million) together with $3 million in cash for stock in the newly formed American Railway Express Company. In 1918, the new express company contracted with the Director General as sole agent to conduct express operations.

Federal control of railroads was ended by the Transportation Act of 1920, which statute also contained a specific grant of authority to this Commission to approve the merg-

er of the four predecessor express companies into American Railway Express Company. Formal approval by the Commission was given in a report of the entire Commission, decided December 7, 1920, *Consolidation of Express Cos.*, 59 I.C.C. 459, which contains most of the background set forth above. On the same date, the Commission also approved the pooling provisions under Section 5(1) of a new operating agreement between the express company and the railroads, *Express Contract, 1920,* 59 I.C.C. 518 (1920). The agreement provided for the division of the railroads into three geographical regions, with revenue computed by region. Expenses applicable to each region where then deducted to reach "Income for Division". Two and one-half percent of this amount was taken as profit by the express company and the remainder distributed to the railroads in each group under a formula based upon the amount of express business handled by each railroad. American Express Railway Company operated under this agreement, with minor modifications, from 1920 until 1929. One modification required that each railroad purchase all express company property located on its line at cost less depreciation if the express company did not continue express operations after February 28, 1929, the termination date of the operating agreement.

The Formation of REA

Certain weaknesses in the post-World War I arrangements for express business appeared early in the 1920's. The railroads found themselves losing substantial sums from their express business. With its fixed percentage of revenues guaranteed, American Railway Express Company was making an adequate return on its investment. The express company's financial condition did not justify an increase in rates, and the railroads found it difficult to convince the Commission that their losses constituted legal justification for an increase. As Commissioner Eastman

stated in a separate expression in a proceeding decided May 17, 1924:

> So favorable did the contract prove that in the second year of its operation the express company made a voluntary additional payment of $1,700,000 to the railroads in order that its profits might not substantially exceed 8 per cent. Later the contract was amended, so that there might be less opportunity for excessive profits; but it still remains true that the express company is virtually insured a reasonable return and that the risk of the business is upon the rail lines. The result is that in the instant proceeding we have a carrier seeking an increase in rates, not for its own benefit, for it concedes that it need no increase, but in order that other carriers which are in its pay may not suffer financially from a contract into which they voluntarily entered. Obviously, the situation is anomalous and fraught with danger so long as the express company remains an ostensibly independent corporation. For their own protection it would seem that the *Express Rates, 1922,* 89 I.C.C. 297, 319 (1924).

The railroads began investigating the possibility of purchasing the express business and operating it on a nonprofit basis as a railroad-owned joint venture with nominal capital stock. On June 21, 1928, a committee of the Association of Railway Executives, the "Uniform Express Contract Committee", which represented the railroads having contracts with American Railway Express Company, adopted a "Report and Plan for Future Conduct of Express Business", The Plan stated that the

> • • • object sought to be obtained by the Plan is to make the future express agency a railroad-owned joint facility engaging in express transportation in its own name, but nevertheless acting in fact as the agent of its railroad principals and accounting to them under the terms of the operating agreement • • • for all of its revenues after payment of expenses. This relationship will make the railroads transporters of express as they are of freight with a consequent like status before commissions and courts.

The 1928 plan contemplated the formation of a new express company, to be called "Railway Express Agency, Inc." (REA). The company's capital stock would consist of 1,000 shares to be sold at $100 per share to 86 "participating railroads". These railroads, which handled 98 percent of the express business in the United States, were allocated the stock under a formula reflecting each road's percentage of the express business which it handled in prior years. The 300 short line railroads, which in the aggregate accounted for only 2 percent of the express business, would not be shareholders of REA, apparently to avoid such problems as fractional shares, but would become signatories to the uniform operating contracts and participate in express revenues.

The new REA common stock could not be sold without offering it first to REA at the original price and, if REA declined the offer, could only be sold to other railroad corporations. The earnings from the express business were not to be distributed on the basis of stock ownership but in accordance with the operating contract. The $100,000 capital stock was not to represent any substantial equity in REA's properties (with a book value of approximately $30 million) but to represent merely the voting rights. It was proposed that REA's board of directors consist of 15 members, with 6 to be nominated by the eastern roads, 5 by the western roads, 3 by the southern roads and one "director-at-large".

Part of the 1928 plan was a proposed standard express operations agreement (SEOA to be entered into between each railroad and REA, the SEOA set forth the terms and conditions governing the railroads' conduct of the express business and made REA the "exclusive agent" for all express business conducted over each contracting railroad's lines.

Of particular importance to this proceeding are the provisions for distribution of express revenues contained in

Article V of the SEOA. The railroads were divided into four groups: eastern, southern, western, and mountain-Pacific. All revenue collected by REA on less-than-carload shipments, 15 percent of the carload revenue and any other revenues were to be so determined for each group. Eighty-five percent of the carload revenue went to the individual railroad for shipments over its lines. However, carload shipment consistently amounted to less than 3 percent of revenues. Thus, the bulk of the revenues were calculated on a regional group basis. Operating expenses and other expense items were similarly ascertained separately for each regional group, and items and charges that were common to more than one group were apportioned among the groups. All these expenses, items and charges were then deducted from the group's revenues, and the remaining amount was called "rail transportation revenue". Among the items that would be deducted were certain "profits and loss debits", including an account under Section 4(j) of Article V of the SEOA for "Surplus Applied to Sinking and Other Reserve Funds". The entire amount of "rail transportation revenue" was required to be paid out monthly by REA to all the railroads contracting with REA pursuant to a formula reflecting the amount of express business done by each railroad. The plan stipulated that REA would realize no operating profit, stating "the express operating agency shall realize no net income for distribution as dividends".

The 1928 plan proposed two alternative methods for purchasing the business of American Railway Express Company: (1) the purchase of all the stock of the express company from the various stockholders, or (2) the creation of a new company which would purchase the assets of the express company. Since the plan contemplated that the express agency would be run on a nonprofit basis, the first alternative was to be adopted only if all the stock of American Railway Express Company could be acquired. Nego-

tiations with the holders of the express company stock were unsuccessful and the second alternative was adopted. Under the plan, the cash required for purchasing the assets of the express business and for initial working capital would be raised by issuing bonds, debentures, or notes of REA. These would either be purchased by the stockholding railroads on a proportionate basis or sold to the public by REA.

The 1928 plan provided it would go into affect when railroads comprising 75 percent of the current express business had executed an "Agreement with Agents", a copy of which was attached to the plan and proposed SEOA forwarded to the railroads in the summer of 1928. The Agreement with Agents appointed four individuals as agents of the railroads and authorized them to incorporate REA and take other steps necessary to implement the plan.

While these authorizations to proceed were being collected by the Committee, a problem arose which eventually led to the creation of the Non-Negotiable Debt, a major subject of our concern herein. As stated above, in the computation of "rail transportation revenue" to be distributed to the railroads, one of the items to be deducted as an expense was "Surplus Applied to Sinking and Other Reserve Funds". The natural assumption from the existence of this account is that the current distributable rail transportation revenues, which were to be based on express business conducted, would be reduced in an amount sufficient to satisfy any sinking fund established to repay debt incurred to purchase the express company assets. This arrangement was challenged by William H. Williams, Chairman of the Boards of the Wabash Railway Company and the Denver and Rio Grande Western Railroad Company.

Mr. Williams met with members of the Legal Committee of the Uniform Express Contract Committee on October 8, 1928, to discuss several objections he had to the 1928 plan.

He described the discussion on a sinking fund in a letter dated October 20, 1928:

> If the company were to be financed in the first instance through an issue of bonds to be taken by the railroads, the latter would be entitled to interest on the outstanding bonds. If, however, these bonds be sold to outside parties, it is expected that the bonds will be retired during the life of the contract with the railroads through the operation of a sinking fund so that, in this way, there would be deducted from revenues properly belonging to the railroads an amount sufficient to retire the bonds. I asked them as to how the property would be divided in the event of dissolution, and they stated on a stock basis. I pointed out, however, that the bonds would be bought by the railroads on the basis that the express earnings of each railroad bear to the aggregate express revenues of all the railroads and, inasmuch as the railroads would be paying over 99% of the cost through the operation of the sinking fund, that the distribution should be on the basis of contributions to the sinking fund and not on the basis of stock ownership. I believe I convinced them of the equity of such distribution.

The same point was made more graphically by the President of the Wabash Railway Company in a letter of the December 20, 1928, to the Chairman of the Uniform Express Contract Committee describing a conference Mr. Williams had with the railroads' Law Committee:

> In the event of dissolution, instead of distributing the assets on a basis of stock ownership, the assets of the corporation should be distributed on the basis of cash contributed by each carrier in the purchase of capital stock of the new Express Company and in payments into the sinking fund of such Express Company.
>
> All conceded it woud be inequitable to distribute the assets on the basis of purchase of some $80,000 or $90,-000, of capital stock, whereas the actual payments by the respective railroads would be on the basis of earnings after the contract became effective and for an amount well in excess of $35,000,000. (The purchase price of the stock was actually $100,000.)

To fully understand the Williams objection, it must be remembered that the railroads were being asked to enter into an entirely new and untried business arrangement of some magnitude. It is to be expected of prudent businessmen that they would be concerned with the financial consequences of the dissolution or sale of the proposed REA, or the withdrawal of participating railroads. The stockholding railroads conducted approximately 98 percent of the pre-1929 express business. If the sinking fund payments were to be deducted before rail transportation revenues *and* the stockholding roads continued to conduct 98 percent of the express business, then they would be contributing 98 percent of the cost of *REA as a group* and ending up holding 100 percent of the ownership. This is not an unreasonable result, considering the problems involved in assigning proprietary interests to the short lines, discussed below. However, *within* the group of stockholding railroads, inequities would arise. As an example, the shares of stock allotted to certain railroads, based on their "percentage of gross express business done by the Railroads in the past" were, as to Mr. Williams' roads, Wabash-12 shares (1.229%) and Denver and Rio Grande-5 shares (.545%), with The New York Central Railroad Company receiving 144 shares for prior express business percentage of 14.426 and The Pennsylvania Railroad Company-126 shares (12.608%). Since there could be substantial variances in the future express business done by the 86 stockholding railroads and there clearly would be some changes in their relative contributions to the total express business transacted, Mr. Williams felt this should be reflected in any distribution of REA's assets.

The Williams objection was the prime impetus for the subsequent decision not to utilize the sinking fund deductions from rail transportation revenue in Section 4(j) of Article V of the SEOA and replenishing of the sinking fund through assessments on stockholders after computation of rail transportation revenues, which were carried as

"advances" on REA's books. Other justifications for the treatment finally adopted became evident to the railroads, but were not all articulated until somewhat later. The method adopted avoided the inequity of having the non-stockholding short line roads making contributions to the capital of REA without any corresponding credit. In soliciting their signatures to the SEOA, the short lines were assured in December 1928 that "the burden of financing the acquisition of the express properties would fall solely upon the participating (stockholding) railroads." Furthermore, with over 300 of these lines, the bookkeeping problems of assigning them some proprietary interest would have been substantial. Since REA would have been taxed on any amount deducted before reaching rail transportation revenues for sinking fund purposes, REA was enabled to escape any income tax liability. Finally, the Commission itself, in its report approving the 1929 SEOA, questioned the distortion of rail transportation revenues caused by the prior deduction of sinking fund payments.

As stated above, the foregoing justifications for the sinking fund arrangement finally adopted had not been articulated in late 1928. In fact, the arrangement itself had hardly been conceived. The railroads' Uniform Express Contract Committee was soliciting acceptances to the plan, which included the SEOA. The Wabash had returned an executed SEOA which was accompanied by a letter making its acceptance conditional on the adoption of certain changes, including the Williams objection referred to above. The Chairman of the Committee, W. D. Storey, in a letter to the President of the Wabash dated December 3, 1928, protested that all the railroads must sign the same agreement and returned the executed SEOA. He went on to say, however:

> *** all the members of the (Legal) Committee are of the opinion that the provisions of Exhibit D (Operating Agreement) would not preclude the Board of Directors of the Railway Express Agency, Incorporated,

from providing as between the participating railroads for proprietary interests by them in a sinking fund set up to protest a bond issue corresponding to their respective contributions thereto, and the Legal Committee has recommended that such action be so taken. In this respect it is the opinion of the Committee that while the Agents would have authority in agreeing upon terms for financing the acquisition of the express properties to provide for a sinking fund to protect a bond issue, the Board of Directors of the Railway Express Agency, Incorporated, must determine how such fund shall be raised.

Mr. Williams and the principals of certain other railroads who had objected on the same grounds were persuaded to participate without changing the SEOA. As Mr. Storey described the situation in a January 1929 hearing before the Commission:

> They (the Williams roads) made the further point that any contributions to a sinking fund should result in a corresponding proportionate interest in the property in the event of liquidation. The Legal Committee gave its opinion *** that the sinking fund contention was sound and could be put in effect without any amendment of the plan or its incidental papers, and the Legal Committee recommended that it be made effective by the board of directors in any sinking fund action. On the understanding that this opinion of the Legal Committee would be circulated among the Participating Railroads and submitted to the Commission at this hearing, this group of railroads has assented to the plan or agreed to do so.

The 1929 Orders and the Creation of the Non-Negotiable Debt

Having received executed agreements from railroads representing 75 percent of the express business, and having reached agreement with American Railway Express Company and its principal stockholders on the basic terms for purchasing the properties of the express company, the plan

for establishing REA was submitted to the Commission. Two applications were filed December 17, 1928, and December 20, 1928. A decision had not yet been reached as to the desired method of accounting for the sinking fund and the relation of the sinking fund to the computation of rail transportation revenue, nor had it been resolved whether the funds for purchase of the express property would be raised from the public or the railroads.

In Finance Docket No. 7322, application was made under section 5(2) of the Act for the participating railroads to control REA by acquiring its capital stock, and under section 20a to issue 1,000 shares of capital stock and to issue not exceeding $35 million of 5 percent bonds. An application was also made under section 20a(12) for officers and directors of the stockholding railroads to hold positions as officers and directors of REA. This application was later withdrawn as separate applications were filed by the persons asking for authority to serve as interlocking officers and directors.

In the application for authority to issue the bonds, it was stated that the proceeds from the bonds would be used to acquire the express business and for working capital. The application states that the bonds would be sold either to the public or to the participating railroads and that the terms of the bonds had not yet been finally negotiated. It was also stated in the application that it was "not feasible at this date" to give details concerning the bonds, but stated that the form of indenture would be filed as soon as practicable.

Approval of the pooling provisions of the SEOA under section 5(1) of the Act was sought in an application filed in Finance Docket No. 7316. In that application, it was emphasized that the new operating agreement differed substantially from the 1920 contract in that the express company's profit was now to be eliminated. REA was characterized as a "railroad-owned joint facility" which would

operate as the "agent" of the railroads "without compensation or profit to itself."

On January 24, 1929, a hearing was held on the two applications before Director of Finance C. D. Mahaffie. Also present was Commissioner Campbell, who is named as the author of the Commission report on these applications. Mr. Storey testified that it had been determined that the bonds would be sold to the public rather than to the participating railroads. Pursuant to an understanding with the Williams roads, testimony was given as to the Williams objections. As stated above, Mr. Storey testified that the Williams contention that "any contributions to a sinking fund should result in a corresponding proportionate interest in the property in the event of liquidation" was sound and that it could be put in effect by the new Board of Directors of REA without any amendment of the plan or the SEOA. Mr. Storey's letter of December 3, 1928, quoted above, was submitted and received as an exhibit to the record as the 'opinion of the Legal Committee." Mr. Storey also testified that approval would be sought for the service by executive officers of the participating railroads on the board of directors of REA or as its officers.

Testimony was also given at the hearing describing the use of the sinking fund account under Article V(4)(j) of the new SEOA for repayment of the bonds. Charles A. Lutz, a vice-president of the express company in charge of accounts, listed certain accounts which were not in the earlier operating agreement, including "409-Surplus Applied to Sinking Fund and other Reserve Funds." According to the transcript, he then stated, "The American Railway Express Company did not use these accounts. If used by the Railway Express Agency, the accounts charged thereto will be deductions before arriving at Rail Transportation Revenue" Mr. Lutz also testified:

> It is not contemplated that the new Express Company will have any substantial amount of taxable net income,

> unless there shall be charges for income or surplus applied to sinking and other reserve funds included in deductions (i) or (j) in arriving at the balance to be distributed as 'Rail Transportation Revenue.' In this event it is understood that the amounts of such appropriations are not allowable deductions in the Express Company's return for Federal Income Taxes. Consequently, in the contingency and to the extent of such appropriations for sinking and other funds, the company will show net income subject to Federal Income Tax and such taxes when accrued will form a part of the deduction under Item (h) for express taxes.

It may be noted at this point that, in the instant proceeding, REA lays great stress on Mr. Lutz's testimony as a representation to the Commission that deductions for repayment of the bonds would be made before computing rail transportation revenues. The railroads contend, with equal ardor, that Mr. Lutz's testimony was replete with conditional phrases and that the Commission was fully aware that a different arrangement was being contemplated.

On February 11, 1929, the Commission approved the applications. *Securities and Acquisition of Control of Ry. Exp. Agency* 150 I.C.C. 423. Approval was given to the railroads' control of REA under section 5(2), the issuance of the bonds and REA's capital stock under section 20a, and the operating agreement under section 5(1) "solely in so far as it provides for a division of earnings" on a pooled basis. It was noted in the report that the application for interlocking directors had been withdrawn, 'inasmuch as separate applications were being filed by the persons asking authority to serve as interlocking directors." (By an order dated February 8, 1929, after finding that "neither public nor private interests will be adversely affected," the Commission granted authority under section 20a(12) for 13 named individuals to post positions as directors and/or officers of REA, in addition to their other offices with other carriers.)

In discussing the approval under section 5(2), the report characterizes the objective of the plan as being, "to provide for the future conduct of the express business through a separate agency, but in effect a joint facility of the railroads controlled by them through stock ownership." 150 I.C.C. 423, 426. The report also stated:

> Furthermore, the earnings of the Express Agency will not be distributed to the stockholders as dividends in proportion to their stock holdings, but the net revenues will be paid over to the participating railroads upon the basis of gross revenue for each company as will be hereinafter described. 150 I.C.C. 423, 430.

The report noted that the bonds would not be secured by a lien on physical property but by an assignment to the indenture trustee of REA's rights under the operating agreements. In discussing the ability of REA to repay the proposed borrowings, the report sets forth the gross charges of the express company for the years 1925 to 1928, estimates the net receipts that would have been available to pay the principal and interest on the proposed bonds, and concludes, "From these comparisons it appears that it may reasonably be expected that the Express Agency will earn many times over the yearly interest and principal requirements of the bonds, and will have substantial earnings for distribution to the railroads entitled thereto." 150 I.C.C. 423, 433.

From the foregoing, it appears that the Commission was not expecting the bond-holders to look to the assets of the express company as security for repayment. However, the last quotation was immediately followed by, "It should also be observed that at the end of 20 years the proposed $32 million of bonds will have been retired, leaving the Express Agency without any funded debt ***." In view of the funded debt which was created through the decision not to use the Article V(4)(j) account, REA naturally places great emphasis on this statement in the present proceeding. The

railroads maintain that there is no indication that the Commission placed any particular emphasis on this observation, or in any way relied upon it.

The railroads place *their* emphasis on the indications in the report that the Commission was not ruling on any specific method of handling the sinking fund, but leaving the matter to be finally settled by the applicants. The report refers to the provision for deductions from revenues for sinking funds in Article V(4)(j) and notes that:

> The effect of this will be to reduce operating revenues of the railroad carriers which they derive from express traffic by amounts which are in reality appropriations of surplus. *It should be understood that all that we are here passing upon is the plan for pooling and dividing earnings and we are not passing upon other provisions of the contract, such as that mentioned above.* Nothing herein contained is to be construed as an expression of opinion upon the propriety of such deductions in connection with the determination of recapturable income under section 15a of the Interstate Commerce Act. 150 I.C.C. 423, 434 [emphasis added].

The last sentence may be regarded as a criticism of this provision as resulting in a possibly improper reduction of reported income for purposes of the since-repealed recapture provisions of section 15a.

A final source of contention in this report is the statement that,

> "so long as any of the bonds are outstanding (REA) will, before making any payments to the participating railroads of any sums due to them under the operating agreements, set aside out of the net receipts for each six months' period ended June 30 and December 30, as a sinking fund, an amount equal to the principal amount of bonds which are due and payable in such six months' period." 150 I.C.C. 423, 432.

REA maintains that this statement required the deduction of sinking fund payments before calculating "rail

transportation revenues." The railroads insist that the Commission attributed no particular significance to the provision in question, and, in any event, the procedure actually adopted conforms to the quotation, i.e., cash for the sinking fund was set aside before any payments were made to the participating railroads.

While a proof indenture dated January 28, 1929, had been filed with the Commission, the indenture for the bonds was not in final form on the date of the Commission's decision, February 11, 1929. The order referred to "an indenture to be made by (REA) under date of March 1, 1929," and ordered that, "within 10 days after the execution of said trust indenture, the Railway Express Agency, Incorporated, shall file a certified copy thereof with this Commission." 150 I.C.C. 423, 441-2.

Counsel for the railroads, the banks, and the trustees had been meeting on various occasions in January and February, 1929 to discuss revisions of the indenture, including changes to meet the objections of the Williams roads to the use of the SEOA's surplus accounts for retirement of bonds and consequent failure to provide an interest in REA proportionate to the continuing contributions by the railroads. The minutes of these meetings and memoranda of the lawyers involved are part of record in this proceeding.

A memorandum dated January 17, 1929, proposed the resolution of the Williams problem by inserting in the indenture a provision "that the sinking fund be charged to the Participating Railroads in the proportion of their stockholdings." This change was not made because, according to "Minutes of Counsel" dated January 28, 1929, "It seemed to us that it was dangerous to embody this in the indenture as full discussion of the matter later may develop some different method of handling the matter which will square with W. H. Williams' views." Similarly, a proposal to include a sentence explicitly permitting sinking fund deductions to be treated as advances was not adopted

at a meeting of counsel on February 11, 1929, because "it implied that without this express provision the deductions could not be treated as advances and further as typing us up to this treatment which may not be the one finally desired." Accordingly, no specific provision was inserted in the indenture referring to a proportionate contribution by the railroad to the sinking fund or to an off-setting entry on REA's books, such as "advances." This was done in reliance on the legal opinions, discussed above, that the treatment of the sinking fund could be determined by the independent action of REA's Board of Directors.

One change in the sinking fund provisions contained in the January 28, 1929, proof of indenture submitted to the Commission was made, which appeared in the final version of the indenture filed on March 5, 1929. The proof of indenture provided, in Section 11 of Article IV, that, as long as the bonds were outstanding, REA will, "before making payment to any of the Participating Railroads of any sums due the railroads under the Operating Agreements," set aside out of its net receipts for each 6 months period the appropriate amount for the sinking funds. (This is presumably the clause referred to in the Commission report quoted above.) After objections on the grounds that this suggested that possibility that the sinking fund payments for a 6-month period were to be set aside out of the first month's distribution to the railroads, the quoted phrase was omitted in the final version of the indenture. At the same time, "net receipts" was defined to mean "rail transportation revenues," without any deduction for sinking fund payments. The railroads state that the original version was inserted for the protection of the bondholders to require that payments be made to the sinking fund before the railroads received anything. They are correct in saying that the final version preserved this priority, *i.e.*, in the terms of cash distribution of express revenues, the sinking fund payment would first be made before distribution to the railroads.

A proposed resolution of the sinking fund questions was discussed at a meeting of the Board of Directors of REA held on February 28, 1929, but action was deferred until the REA stockholders had elected the permanent board of directors. The minutes of the meeting of the REA board of directors on April 11, 1929, state that the chairman reported that certain railroads had objected to the railroad companies contributing to the sinking fund contributions." The chairman added that the Legal Committee "had ruled that such provision could be made under the Plan." The board then adopted a resolution providing that "there be deducted from the share of Rail Transportation Revenue payable to each stockholder in the months of February and August in each year $800 per share of the capital stock of this Company held by such stockholders respectively, such deductions to be credited to such stockholders as money advanced to this Company." The resolution further provided that the advances would be used to pay the principal on the bonds and the REA would credit or pay interest on the advances at 5¼ percent per year.

On June 18, 1929, REA's vice president of accounting Charles Lutz, sent a letter to the chief accounting officers of REA's stockholders, enclosing a copy of the board's resolution of April 11, 1929, and stating that the amounts deducted pursuant to the resolution would be entered on REA's books "to the credit of your company in an account styled 'Non-negotiable debt to affiliated companies—Advances' and will bear interest at the rate of 5¼ per annum * * * ."

In such manner was the Non-Negotiable Debt created. From a distance of 45 years, it is not difficult to attribute to its creation motives which may be devious or laudable, depending on one's vantage point. It may be helpful to quote some reasonably contemporaneous descriptions of the rationale for the adoption of the "Non-Negotiable Debt-advance" method of retiring the bonds. These comments were made in connection with the determination by the

REA board of directors in 1930 to adopt the same method in raising working capital for REA as well as funds for additions and betterments, i.e., by borrowing from each stockholder through advances to be deducted from the railroads' share of rail transportation revenue. While they are of some length, they do afford insight into the thinking of the parties involved at that time, as well as summarizing the mechanics and the effect of the choice.

A "Memorandum for Mr. Charske" (sometime head of the REA Finance Committee) dated January 27, 1930, from a member of the Legal Committee, H. W. Clark of the Union Pacific Railway Company, discussed the power of REA to raise money for working capital by appropriating funds before determining the amount of "rail transportation revenue" distributable to the railroads. The memorandum refers to the provision in the SEOA for the account entitled "surplus applied to sinking and other reserve funds," but recommends that REA not:

> * * * exercise this right of deduction in the case of appropriations for capital purposes. Since it was finally decided not to require the short lines to bear any part of the cost of the acquisition of the American Railway Express Company properties, it would be inconsistent to make them share in future capital items. It is illogical to require contribution from the short lines through income deductions for which they would not receive in return any interest in the surplus. This latter objection could, to be sure, be obviated by giving the short lines notes or an open account credit for the amount of such deductions, but the large number of accounts involved in that arrangement would make it amount to an intolerable nuisance. There would be some inconsistency also, as to the stockholding railroads, in making such deductions from income, in the proportion of the express business done by them, while their interest in the resulting surplus would be in the proportion of their stockholdings. This last objection of inconsistency was raised by Mr. W. H. Williams after the Express Plan had been adopted by the requisite number of roads and had been declared effective.

> He urged that in the event of sinking fund applications of income, there should be secured to the contributing carriers a proprietary interest in such sinking fund proportionate to their respective contributions thereto. The Law Committee ruled that this could be accomplished under the Plan without amendment and recommended that such action be taken by the board of directors when constituted. The assent of Mr. Williams to the Plan was induced by this ruling and recommendation. The board of directors of the agency subsequently took action providing for the payment of bond maturities which, while not in just the form suggested by Mr. Williams, observed the principle of his criticism. The same reasons dictate the observance of property and other appropriations for capital purposes.

At the REA board meeting of January 28, 1930, the Finance Committee recommended that working capital be raised by borrowing through advances from stockholding railroads. The board approved the recommendation. The minutes show the following explanation by the Finance Committee:

> We are not unmindful of the provision under item (j) of Section 4, ARTICLE V, of the Operating Agreement for the setting aside of surplus for investment in physical property but it is our opinion that the Board should not act under this provision, because (1) it would take from nonstockholding railroads money for investment in property in which they would have no proportionate to the amounts thus charged to them; and (3) there would be no interest charge in the operations of the Agency on the cost of the property.

The president of the Chicago, Indianapolis & Louisville Railway objected to being required to make advances to enable REA to acquire property and contended that REA must use the surplus accounts in ARTICLE V(4)(j) of the SEOA. Mr. Lutz of REA replied by letter of March 5, 1930, and stated that the use of the surplus accounts was "voluntary on the part of the Agency, and the Board has

decided in this case and in the case of the funds required to retire Maturing Bonds not to use them." The letter recited the Finance Committee's explanation which is quoted above and went on to state:

> In addition to the reasons assigned by the Committee there is the further objection to the use of these accounts that such a situation would present the anomaly of contributions to the capital of the Agency by the contract rail lines out of revenues and a progressive increase in the equity of the stock of the Agency held by the "participating railroads" without the reflection in their asset accounts of the cost or value of such increase. This objection was voiced by Commissioner Campbell in the hearing and conference in Washington in January, 1929 when the approval of the Operating Agreement and of the proposed issue of bonds was under consideration in Finance Docket Nos. 7316 and 7322.
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> It would appear that the payment of interest to carriers upon the advances made would really place these investments in about the same category as contributions to the capital of a joint facility, such as a union station, by proprietary rail roads. In other words, the capital provided through the advances yields 6 percent interest to the creditor, and such interest when charged into the income statement by the debtor is borne by the users of the property in the proportions of the use made by them, respectively. In these circumstances, the interest rate being fair, it would not make a great deal of difference how the amounts of the capital obtained is distributed among the interested railroads.

Accounting and Tax Treatment by REA and Railroads

In its first annual report to the Commission for the year ending December 31, 1929, and in all later annual reports, REA reported its obligation on the advances as "nonnegotiable debt" and part of its total debt, along with the bonds issued in 1929. Included in these reports was information as to the amount of advances made by each stockholder, the interest rate, and the interest paid by REA on

the advances. In their annual reports to the Commission and other reports, the railroads consistently treated the Non-Negotiable Debt as debt (and not equity). Most of the railroads placed the advances in an account for "Investment in Affiliated Companies-Advances." The interest received by the railroads from REA was generally recorded in the Commission account for "Interest Income."

For tax purposes, REA charged interest payments on the advances as an expense. The railroads took into income for tax purposes the full amount of rail transportation revenue owed to them by REA prior to any deduction by REA for advances. Similarly, REA treated as an expense for tax purposes the full amount of rail transportation revenue owing to the railroads prior to the advances.

This uniform treatment by REA and the railroads of the Non-Negotiable Debt as debt, and no equity, is also illustrated by certain transactions during the 1930's. In 1935, REA repaid the railroads $388,097 in advances representing the amount charged off as discount on the bonds. In 1936, REA found that it had "on hand more cash than needed in its present operations" and repaid $2.4 million in advances on the basis of $2,400 per share. In 1938, Southern Railway and its affiliated lines sold their express company to REA and became REA stockholders. REA purchased 24 shares of stock from its shareholders for sale to Southern and, according to REA board minutes, "reimbursed" the holders from which the stock was purchased for the advances made by them aggregating $255,407.37.

While the advances were entered on REA's books as debt, according to a letter of Mr. Lutz, dated March 24, 1931:

> No notes, receipts or other forms or evidences of indebtedness were issued for those advances, because to issue notes would have necessitated the approval of the Interstate Commerce Commission. It was assumed that the advices given by this office to the several railroads on Form 7102-A, a copy of which is enclosed, would be sufficient to evidence the indebtedness.

The "advice" referred to Mr. Lutz was a form entitled "Advance Advice of Express Privileges" which showed an estimated amount due the railroad under SEOA for its express business during the prior month, deduction as "an advance by stockholders toward retirement of the bonds," and a "Net Amount payable." A check for this last amount would be forwarded within the current month, and the railroad would be advised of the actual amount due to it when the figures became available. The advice was signed by Mr. Lutz.

The 1938 Notes

With interest rates reaching new lows in the Depression, REA decided in 1938 to retire the remaining $16 million of 1929 bonds through the issuance of new notes. A 10-year note issue of $16 million was planned, under an indenture with Guaranty Trust Company of New York, with the interest rate to increase gradually from 0.375 percent in 1938 to 2.5 percent in 1948. As in the case of the 1929 bonds, the notes were to be secured by a pledge of REA's rights under the SEOA. REA would retire the notes in the same manner as the 1929 bonds, by taking advances from stockholding railroads. In contrast to 1929, the indenture for the 1938 notes expressly provided that the principal was to be paid by advances from stockholders. The terms for making the advances were set forth in identical "stockholding agreements" between REA and each stockholder. Under these agreements, the advances were to be deducted monthly from each stockholder's share of rail transportation revenue and had no fixed maturity date. The agreements expressly referred to the prior advances, which were to continue to be be made until the 1929 bonds were actually retired.

The stockholding agreements provided that the advances were to be subordinated to the notes and were to bear interest at a rate fixed by the REA board but not to exceed 5 percent.

A December 17, 1938 letter from a member of the Finance Committee stated that the interest rate on the advances was a "wash transaction" since the result would be an equivalent increase in the amount of rail transportation revenue. The letter further stated that "even though this payment of interest was a bookkeeping transaction," the board had reduced the rate because "the picture of the owing railroads paying themselves 6% upon advances just to retire serially 5% bonds would be the unthinking accuse the management of milking the company at the instance of the larger railroads." He stated, "Again I repeat whatever is saved in interest is gained in rail transportation revenue."

Before the Commission acted on the application for authority to issue the notes, REA's general counsel sent a letter to the Commission's Director of Finance in which he referred to the application, enclosed a copy of the stockholders agreement, and inquired "whether the authority of the Commission is necessary for railroad companies to execute such agreements as constituting an assumption of obligation of liability under Section 20a." The Director replied by letter dated December 5, 1938, stating that it was the "view of this bureau" that there was no need for section 20a approval since, in his view, the agreements did not impose any obligation on the railroads, which were merely "acquiescing" in acts performed by REA.

In response to an inquiry from an investment banker asking whether competitive bidding was to be required in the sale of railway bonds, the Chairman of the Commission, by letter dated November 25, 1938, referred to the REA notes offering then pending and stated that the Commission

"has not adopted any requirement as to the offering for sale through competitive bidding bonds and other securities of railway companies, such equivalent requirement being applicable only to the sale of equipment-trust certificates."

On December 20, 1938, the Commission approved the issuance of $16 million of notes pursuant to section 20a. *Railway Exp. Agency, Inc., Notes,* 230 I.C.C. 473. In its report, division 4 made the following comments on the advances:

> Funds for the payment of the notes as they mature are in effect to be advanced pursuant to proposed agreements to be dated as of December 1, 1938, between the applicant and the several railroad companies constituting its stockholders. Under the terms of the agreements the applicant will deduct monthly from the share of rail transportation revenue payable to the several companies, computed under the provisions of the operating agreements with them, such an amount as will be sufficient to accumulate funds to pay the notes as they become due, the amount deducted monthly to be such proportion of the total principal amount to be paid as the number of shares of the applicant's capital stock held by that railroad bears to the total number of shares held by all the railroads which have entered into such agreements, the foregoing provisions to prevail except under certain conditions, as more fully set forth in the agreement. These advances will bear interest at such rate not to exceed 5 percent per annum, as may be fixed from time to time by the applicant's board of directors, but all advances, either in existence at the date of the agreements or made pursuant to them, are to be subordinated to the payment of the notes issued under the proposed indenture. 230 I.C.C. 478, 479-80.

Following the issuance of the 1938 notes, all parties concerned continued to treat the advances as creating a valid debt of REA to the railroads. These parties included this Commission and United States District Court Judge Carrol

C. Hincks, who was required to review the advances in December, 1938, in connection with the reorganization of the New York, New Haven and Hartford Railroad Company. Judge Hincks was provided with a detailed history of the origin of the advances by the General Counsel of REA, who justified the failure to use the surplus accounts for the sinking fund as a means of avoiding the contribution by nonstockholding railroads to the purchase of REA. Their general counsel stated that the resolution of April 11, 1929, was adopted to "satisfy some of the railroads who, of course, would not have signed * * * and also to satisfy * * * the objection of some of the Commissioners, and in what they thought to be the fair thing to do, namely, that the stockholders should put up the money for the property * * * *" Judge Hincks concluded that REA's board of directors could lower the interest rate of the advances, a right contested by the Reconstruction Finance Corporation, to which the New Haven has assigned its advances.

At a hearing in 1947 before the Commission on a simplified accounting plan (the "economy plan") which REA had adopted, REA's vice president of accounting testified in detail concerning the history and nature of the advances in response to questions by Commissioner Splawn. The proceeding arose when the Commission questioned the legality of the economy plan under our pooling provisions of the Act. The REA vice president described the advances as on "unsecured obligation" that "is not evidenced by notes of any kind" and explained that REA had to "borrow" this money from its stockholders in order to pay the principal on the 1929 bonds and 1938 notes. He described the effect of interest payments on revenues as follows:

> The interest payments become a deduction in arriving at rail transportation revenue distributable on the carriers but inasmuch as the payments are made to our stockholding carriers and they receive over 99% of the rail transportation revenue, substantially the same carriers get the payments as would receive them in rail transportation revenue as if no interest payments were made.

In this report on this proceeding, *Express Earnings, Plan and Method of Division,* 278 I.C.C. 505 (1950), the Commission concluded that:

> Upon further consideration, we are of the opinion that the action of the Agency in adopting the economy plan without applying to us for a supplemental order was in no way unlawful. In considering the present arrangement, as well as its predecessor in 1920, we pointed out specifically that we were approving only the general plan for pooling and dividing earnings and were not passing upon the particular provisions of article V or any other part of the contract. *Express Contract* 1920, 59 I.C.C. 518, 523; *Railway Exp. Agency, Inc., Securities and Control* * * * (the 1929 proceeding). 278 I.C.C. 505, 509.

The 1929 operating agreement was again considered by the Commission in a proceeding which has some similarity to the present proceeding. In 1948, the United States brought an antitrust action against REA charging that those portions of the operating agreement which constituted REA as exclusive agent of the railroads violated the Sherman Act. REA petitioned the Commission to either clarify or supplement its prior orders under section 5(1). The district court granted a stay of the judicial proceedings. *Unnted States* v. *Railway Express Agency, Inc.,* 89 F. Supp. 981 (D. Del. 1950). After conducting a hearing, the Commission complied by explicitly approving the exclusive agency aspect of the pooling agreement in both a report and order. *Express Contract, 1929,* 275 I.C.C. 739 (1951). Findings express Commission approval of the challenged activity, the district court dismissed the antitrust action. *United States* v. *Railway Express Agency,* Inc., 101 F. Supp. 1008 (D. Del. 1951).

The 1954 Operating Agreement

In anticipation of the expiration of the 1929 operating agreement in 1954, extensive consideration was given to the problem of repaying the advances, especially in the event of liquidation of REA or withdrawal by one or more railroads. Several memoranda in the record indicate that in 1952, the eastern railroads were in favor of dissolving REA or withdrawing, with the western and southern roads opposing this.

By application filed July 24, 1953, a new operating agreement was submitted to the Commission for its authorization under section 5(1) of the Act. The agreement, which was to expire on December 31, 1973, was similar to the 1929 agreement. The provision for distribution of REA's earnings was rewritten and amplified in some respects, but REA continued to be a non-profit agency of the railroads. All its net earnings were to be distributed to the signatories of the 1954 agreement, which expressly provided that REA would have no net taxable income.

The 1954 agreement differed from the 1929 contract in providing that a railroad could withdraw before the expiration date of the contract. If a railroad withdrew, it was obligated to purchase all express company buildings on land owned by the railroad and might be required to purchase all express company buildings on land owned by the railroad and might be required to purchase on demand other express company buildings, land or equipment used solely or chiefly on the lines of the railroad. The withdrawing railroad could apply up to 75 percent of its outstanding advances for the purchase price of the property. Remaining outstanding advances would not be redeemed but would bear the same rate of interest as "borne by similar indebtedness owed by" REA and would be repaid when the other stockholders' advance were repaid. In the event of liquidation, the advances were to be subordinated to REA's other liabilities and were, along with capital

stock, to be treated as "capital debt" for purposes of pro data distribution of REA's remaining assets. On November 4, 1953, the Commission approved the pooling provisions of the 1954 agreement. *Express Contract, 1954,* 291 I.C.C. 11. The Commission noted that the new provisions for withdrawal "should remove objections to the alleged monopolistic character of the exclusive-agency provision." 291 I.C.C. 11, 12.

Between 1954 and 1959, the status of the Non-Negotiable Debt was subjected to close scrutiny by the railroads, REA, banks and outside counsel on several occasions. It became important to determine whether the Non-Negotiable Debt should be considered debt or equity in connection with several transactions. These included: the question whether subordination of the Non-Negotiable Debt was required for REA to borrow from outside parties; the demand of Nevada Northern Railway, which had not signed the 1954 operating agreement, for repayment of its advances which demand was met; a proposed reduction of the interest rate on advances in 1955; and the status of the debt raised in 1957 by a bank making temporary loans to REA. Examinations of some depth were made in each instance and the resulting legal memoranda are included in the record of this proceeding.

While there was a substantial question whether the Non-Negotiable Debt should be considered debt or equity, it should be pointed out that the records contains no suggestion that the Non-Negotiable Debt is completely invalid, the position taken by REA in this proceeding. In each of the above-cited transactions where the debt-equity question was raised, the opinion was given that the Non-Negotiable Debt was debt and not equity and action was taken on that basis. The only exception to the "debt" view was expressed by a Vice President of REA, C. J. Jump, who was trying to convince the Guaranty Trust Com-

pany that it was unnecessary to have the railroads agree to subordinate the debt to a proposed loan by the bank to REA. In a letter of May 1, 1957, Mr. Jump states, "I have expressed the feeling that these advances do not represent a debt by Railway Express Agency to the stockholders". The lawyers for the bank disagreed, viewing the advances as a debt of REA, but decided not to require subordination.

In the memoranda discussing the debt-equity question, factors tending to the "equity" conclusion are given, such as contribution in proportion to stock-holdings, the absence of REA income to repay the principal of the Non-Negotiable Debt, and the indefinite terms for repayment. In support of the "debt" conclusion, it is pointed out the essential elements of a debt are present, since the amount owed is definite and the tme for repayment—on demand after maturity of the outstanding notes—can be ascertained. Among the arguments supporting the "debt" conclusion, the following excerpt from a 1955 memorandum is of interest:

> There are several factors which do support the status of the advances as a debt. From the first the advances have been so treated and interest has been paid thereon without objection from any of the parties in interest. The advances are set up on the books of the agency under the heading 'Non-Negotiable Debt to Affiliated Companies.' Such open account advances are quite common in the practices of carriers in dealing with subsidiary and affiliated companies. The strongest of all is the fact that in the report of the Commission in Finance Docket No. 12242, *Railway Express Agency, Inc., Notes,* 230 I.C.C. 478, (1938), the Commission, in passing upon the refinancing of the then outstanding bonds of the original indebtedness, in order to avail of lower interest rates, specifically referred to the agreement dated December 1, 1938, between the Railway Express and the stockholding railroads, under which the arrangement of advances was to be continued and a rate of interest not to exceed 5% per annum thereon

> was to be paid. The Commission thereby gave it approval of the arrangement at least insofar as it affected the financing then under consideration.

THE 1959 OPERATING AGREEMENT AND THE 1959 NOTES

In the report of division 3 dated September 21, 1959, in *Express Contract, 1959,* 308 I.C.C. 545, the events leading up to the 1959 application to substitute a new agreement for the 1954 operating agreement are described. The dissatisfaction of the railroads with their express operations since 1954 had been evidenced by the withdrawal of several smaller carriers. One large eastern carrier had served notice of its intention to withdraw at the end of 1959 and there were indications that other eastern carriers would follow. The report attributes these actions to the out-of-pocket deficits the railroads were experiencing from their express traffic, which amounted to approximately $16 million in 1955, $24.5 million in 1956, and $40 million in 1958.

These losses from the express business, which the railroads had incurred in varying amounts since 1929, are referred to by the railroads in the instant proceeding as the "Railroad Subsidization of REA." REA naturally objects to this terminology since it claims the railroads were enormously enriched by REA on the basis of the investment of only $100,000. It is clear that there was a net annual multi-million dollar deficit from the cost to the railroads providing services and facilities to REA for express operations despite their revenues from REA. See *Express Rates, 1938-1939,* 213 I.C.C. 471, 505 (1939) (refers to Federal Coordination to Transportation study which shows expenses and taxes in express service exceeding receipts in 1933 by $54 million); *Increased Express Rates and Charges, 1946,* 269 I.C.C. 161, 179 (1947) (express revenues $91 million less than costs in 1946); and *Express Rates and Charges, 1953,* 289 I.C.C. 249 (1953) (express deficit of $92 million in 1951 and $47 million in 1952). It is also clear that REA was not bearing any of these large

losses. This was due to the nature of REA, which was established as a non-profit agency which would have no net income. If REA's own expenses increased faster than its revenues, REA's expenses would be fully covered while the amounts paid to the railroads would decrease proportionately, even though the railroads' own costs for carrying express might be increasing. Commissioner Eastman used the objectionable term when he called REA "in effect a subsidized company" since the railroads "assumed the real financial burden of the express business." *Express Rates, 1938-1939,* 231 I.C.C. 471, 505 (1939).

The exact amount of losses being borne by the railroads from the express business and the causes, be it discontinuance of passenger trains or motor vehicle competition, are not material to our inquiry herein. REA has produced some evidence that, in certain instances, railroads were benefitted by their loss operation of express service since the losses from continued passenger train service would be even greater without express service. The debate of the parties on this point need not be further described. It is sufficient to state that the losses being borne by the railroads from the express business were sufficient to cause them to propose significant changes in REA's operations.

A committee appointed by the REA board recommended that a new operating agreement be adopted which would put REA on a profit and loss basis. The committee also recommended that, "In connection with the new contract," REA issue notes to evidence the Non-Negotiable Debt with the purpose being "to make clear that the advances are in fact debts, and to establish formally the circumstances under which such notes become due and payable." On July 15-16, 1959, the REA Board of Directors authorized the issuance of promissory notes to evidence the Non-Negotiable Debt, and authorized the execution of a new operating agreement.

The principal objective of the new SEOA was to end REA's traditional non-profit mode of operation in the hope

that this would lead to greater efficiency and cost consciousness on the part of REA's officials and employees, and that improved performance would make REA a profitmaking entity. The distribution to the railroads of REA revenues on a percentage basis was to be replaced gradually by a system whereby REA would purchase rail space on a basis related to the railroads' out-of-pocket costs. The transaction was to be completed by January 1, 1963, at which time half of the express revenue remaining after payment of REA's operating expenses and rail transportation charges would be retained as profit by REA. The provision in the 1954 agreement that REA would have no taxable income was deleted.

The 1959 contract also made significant changes in the provisions for withdrawal. Under the 1954 contract, a withdrawing railroad was required to purchase the express property located on its line and to pay its proportionate share of REA's total liabilities. In contrast, the 1959 SEOA provided that any railroad could withdraw from the contract after June 30, 1969, on 12 months' notice and the capital stock of REA held by the railroad would be sold to REA at its original cost.

On July 23, 1959, an application for authorization under section 5(1) of the pooling provisions of the new agreement was filed with the Commission. A hearing was held on the application of August 18, 1959, before two Commission hearing examiners. The transcript indicates that William B. Johnson, president of REA, in outlining the new plan for continued operations of REA, testified:

> Another feature of the plan is the issuance of notes to the railroads to cover their loans to the Express Company which have heretofore been carried on the Express Company's books simply as an open account debt to affiliated companies. An application for authority to issue these notes will be filed with the Commission in two or three days.

An application seeking authority pursuant to section 20a to issue the notes to evidence "existing indebtedness * * * heretofore carried by (REA) as an open account on its books" was filed on September 1, 1959. The pooling application was approved on September 21, 1959. *Express Contract, 1959,* 308 I.C.C. 545. In its report, Division 3 commented on the new pooling arrangements, noting that, "In some respects the proposed agreement removes grounds of criticism directed to previous contracts. The conditions for withdrawal of dissatisfied participants are liberal and reasonable." 308 I.C.C. 545, 550.

By order dated September 25, 1959, Division 4 of the Commission authorized REA to issue to 66 of its controlling railroad companies "5-percent non-negotiable promissory notes in the total principal amount of $27,637,053.80" in order to evidence the indebtedness arising from "funds advanced to it on open account to pay the principal amount due on the bonds and notes by it" in 1929 and 1938. The notes were to mature on December 31, 1973, and provided that 10 percent of REA's profits under the 1959 operating agreement after January 1, 1965, would be set aside to make payment on principal. No dividends could be paid by REA until the notes were discharged. In approving the issuance of the notes, the Commission found the issue to be "for a lawful object", "compatible with the public interest", "necessary and appropriate for and consistent with the performance by (REA) of service to the public as a common carrier, and which will not impair its ability to perform that service."

On three different occasions subsequent to the 1959 order approving issuance of the notes, the Commission considered and approved modifications of the 1959 order. These include a modification in 1969 to permit subordination, authorization to consolidate notes in 1963, and the removal of the requirement that shareholders be railroad corporations in 1962.

Sale of REA

The events following the 1959 orders are well summarized by Judge Metzner:

> In the next several years, the earnings picture for the company got no better, and in 1967 and 1968 REA management made several unsuccessful attempts to find a purchaser for the REA stock owned by the railroads. REA's financial adviser informed management that no interested purchaser would be found unless the 1959 operating agreement was terminated and REA freed from railroad control. In light of this advice, most of the shareholding railroads deposited their stock in a voting trust on June 10, 1968, the trustees of which were not associated with the railroads. The trustees were given full powers of shareholders, including the power to sell their shares if the owners of voting trust certificates representing a majority of the deposited stock approved the sale. In addition, by June 18, 1968, is was agreed that the 1959 operating agreement be terminated on December 31, 1968. 343 F. Supp. 851, 855.

In November 1968, Spenser D. Moseley was hired as President and Chief Executive Officer of REA and set about "building a new management team". By February, 1969, F. Ralph Nogg, Edwin G. Ross, Tom Kole, and Miklos Korodi had joined REA in senior executive posts. In June, 1969, these five REA executives offered to form the REA Holding Corporation for the purpose of purchasing the stock of REA. Under the offer, the Holding Corporation, which was to be controlled by the five executives, would purchase the outstanding REA stock held by the railroads at $1 per share plus warrants to purchase shares of the Holding Company at various times and prices. With slightly more than 2 million shares of REA outstanding, the purchase price would thus be approximately $2 million.

The offer provided, as to the price of the stock to be purchased by exercise of the warrants, that:

> the purchase price may be paid either in cash or by cancellation of 5% Notes due December 1, 1973 ('5%

Notes') or 5% Subordinated Notes due December 1, 1973 ('5% Subordinated Notes').

The offer also stated that:

> the Holding Company will contribute all cash proceeds received by it from exercise of Warrants to REA, and, so long as there are outstanding any 5% Notes or 5% Subordinated Notes, such cash proceeds will be set aside and used solely to pay principal and interest on such 5% Notes and 5% Subordinated Notes.

The offer was accepted on behalf of virtually all railroad stockholders and the sale was consummated in August 1969. The final sale embodied the terms of the offer in recognizing that the warrants could be paid for with the 5 percent notes, and in covenanting that the Holding Corporation would apply cash received in exercise of the warrants to payment of the principal and interest on the 1959 notes.

After the new owners took control of REA, they continued until September 1971, to make the semi-annual interest payments on the 1959 notes as they fell due. At that time, REA, under its new ownership, filed a complaint in the United States District Court for the Southern District of New York initiating the legal action described herein as the REA Lawsuit.

Discussion

I. Was the Non-Negotiable Debt "Debt"?

The critical event leading to our involvement in this proceeding on reconsideration appears to us to be the filing of a memorandum of September 5, 1972, on our behalf in the REA Lawsuit, which memorandum contained the following statements:

> The Commission desires the views of the parties on their basic assumption that the non-negotiable debt constitutes evidence of indebtedness. If the non-negotiable debt in fact represented but railroad equity in

> REA, then much of the present controversy may evaporate, and the 1959 notes perhaps were incorrectly approved.

The court was thus presented with a suggestion of error by an administrative agency, a request by that agency for an opportunity to rectify the error, and the further suggestion that agency action would resolve much of the controversy before the court. While the Judge responsible for the case, Judge Metzner, did not accept the offer, a three-judge panel did, on appeal, accepting at the same time our offer to explore certain antitrust questions raised in the REA Lawsuit.

We will first consider the nature of the Non-Negotiable Debt. Before giving our own views on this issue, we will outline the contentions of the railroads, of REA, and of the Office of General Counsel. We wish to make it clear that we are here discussing the views of the Office of General Counsel expressed at the earlier stages of this proceeding. We can assure the parties that, in accordance with our order of June 11, 1974, the Office of General Counsel has not participated, in any manner, in the decisional process concerning the merits of this proceeding. However, we feel it appropriate to discuss certain contentions emanating from the Office of General Counsel on this issue, due to the active role taken by that Office in initiating our participation in this proceeding and framing the issues, and due to the contention put forward by that Office that the Non-Negotiable Debt may represent "equity", a proposition rejected by both the railroads and REA.

It may be useful to set forth again the questions in our order of January 9, 1973, relating to this issue:

> 1. Did the non-negotiable debt represent the build-up of railroad equity in REA by its railroad parents?
>
> 2. Did REA's repayment of that deft or interest thereon represent a return of or on equity capital?

3. If the answer to numbers 1 or 2 is "yes" what legal or practical consequences should flow from that finding?

As pointed out above, neither the railroads nor REA contends that the Non-Negotiable Debt represented an equity interest. Therefore they both treated these three questions as a single matter, with the railroads maintaining that the Non-Negotiable Debt represented "debt" and REA characterizing the Non-Negotiable Debt as either "sham" or "void". Put another way, the parties answered questions 1 and 2 in the negative, which disposed of question 3. We will follow the treatment chosen by the parties.

A. Railroads' Contentions

* * *

REA's Contentions

* * *

* * * By order dated April 10, 1973, discovery before an Administrative Law Judge was ordered by the Commission. The discovery proceeding was assigned to Administrative Law Judge von Rinteln. Following an initial prehearing conference, on June 18, 1973, a report and order of Administrative Law Judge von Rinteln was served in which the procedures and a time-table for discovery were established. Included in this document was an extended discussion of the merits of this proceding as well as conclusions on the factual and legal matters raised by the Commission in its order reopening the proceeding. Certain railroad parties to this proceeding filed a motion to strike this discussion on the grounds that the Administrative Law Judge's statement of his conclusions on the merits of this proceeding clearly exceeded the task he was assigned by the Commission. However, he was apparently motivated by a sense of fairness to the parties. As he stated in the report, "The parties were advised at the initial session of the pre-hearing conference of the foregoing views of the Administrative Law Judge; i.e., that REA

has already made a case for voiding the non-negotiable notes." p. 13.

The conclusions of the Administrative Law Judge may be stated succinctly in his words, "Thus, the pooling agreement approved by the Commission provided for no debt obligation as between the Express Agency and the stockholding railroads; no money was ever actually advanced to the Express Agency by the stockholder railroads; and the procedures followed were contrary to those provided in the pooling agreement. It follows therefore, that there never was a debt owing the railroads by REA. * * * Since there was no debt, it follows there was no consideration for the 1959 notes. In such circumstances the Commission would be warranted in vacating the 1959 approval of the notes." p. 13. In this respect, our order of July 25, 1973, denied said motion to strike as the matter entitled "Tentative Statement of Facts and Conclusions Based on Facts Already of Record" was properly described as tentative only, did not act to prejudge the case or to limit the scope of the discovery sought herein, and was not shown to prejudice materially the railroad movants.

Office of General Counsel's Contentions

* * *

Conclusions

The foregoing exposition of what we have termed "the views of the Office of General Counsel", rightly or wrongly, has been for the purpose of setting forth the legal motivation for our reentry into this proceeding. We can now reexamine the grounds for our action in our reopening of January 9, 1973, in light of the vast infusion of evidence since that time. As to certain of the legal arguments raised by the Office of General Counsel at the time of the reopening, we find them to be of slight consquences. As to others, the issues raised were valid and the evidence received was necessary in order to evaluate their merit. While we disagree with the conclusions reached by our staff in 1973, our disagreement is based on the evidence produced in this

proceeding, primarily through discovery. It is this aspect of our efforts which we hope will be of assistance to the district court when it considers this matter.

The major issue raised by the Office of General Counsel, "Did the non-negotiable debt represent the build-up of railroad equity in REA by its railroad parents?", received perfunctory and negative responses from the parties. We agree with the parties that there are virtually no grounds for terming the Non-Negotiable Debt an "equity" interest. For the same reason, we also concur in the negative response to the parties to question No. 2 in our January 9, 1973, order, which asks if the repayment of the debt or interest thereon represented a return of or on equity capital. Having disposed of the "equity" question, we are still left with the question whether the Non-Negotiable Debt was in fact, "debt".

The parties responded at length on the issue whether any debt existed and this will be further discussed below. In most respects, their arguments were on different grounds than that of the Office of the General Counsel, which appeared to be contending that no debt could have been created since no moneys were actually paid to the railroads from which the railroads could make the advances to REA. This argument, as set forth in the Appendix 10, 1973, report, holds that, so long as REA deducted the sinking funds payments before transmitting rail transportation revenue, no obligation could be created on the part of REA for the advances. This contention is totally without substance and we cannot agree. We see no legal prohibition against an agreement which provides that a portion of moneys due a second party (the rail transportation revenue due a railroad) can be deducted by the party receiving the moneys originally (REA) to fulfill an obligation of the second party and create a valid debt without physically transmitting the moneys to the second party. The parties did so contract in this case.

The third and final argument of the Office of General Counsel was that procedures followed by the parties in 1929 differed from, or "were contrary to", the procedures approved by the Commission in its 1929 order approving the operating agreement. This is also the major argument of REA. Given the facts available in 1972, there was legitimate cause for concern that the Commission had been misled in 1929. As the situation appeared to us in 1972, and as it was described in Judge Metzner's opinion, through the action of the REA Board of Directors *immediately following* our approval of certain transactions in 1929, a system involving "non-negotiable debt" and "advances" was established. No mention of either the non-negotiable debt or advances was found in our two 1929 reports on the transactions and the result of these then unauthorized transactions was the creation of some $30 million in debt. Viewed in this light, the alarm shown by the Office of General Counsel seems appropriate. Even if the most damaging assumptions are made with regard to these events, however, we are not necessarily led to the conclusion that we thereby compelled to revoke and order made 30 years later approving the notes of REA. Unless approval under section 20a is required, a matter discussed below, the failure of the railroads to follow the procedures described in our reports would not render the Non-Negotiable Debt void, and, accordingly, would not require revocation of the 1959 order approving the notes.

In any event we are not called upon to rule on the consequences of a conscious deception of the Commission in 1929. From the evidence received in this reopening, we are satisfied that the railroads, and the fledgling REA, had sufficient business reasons for the change in sinking funds procedures and that the timing was not arranged to mislead the Commission. As was brought out in this proceeding, the objections of the Williams roads were raised at a late and critical stage in the establishment of REA, when signatures

were being gathered from the scores of other railroads. The objections were made known to the Commission before any rulings were made. The desire of the Williams roads to firmly and fairly fix rights upon liquidation are understandable in view of the amounts involved and the hazards of entering into an untried venture. Given the uneven record of the previous arrangements for handling express business, it was not unlikely that a new start might be soon made again. In addition, the problem of the short line roads contributing without a compensating benefit was a legitimate concern.

With respect to the alleged deviation from the procedures approved by the Commission in its 1929 orders, we question whether this charge, even if proven, would require us to revoke the order which the district court has directed us to consider, our 1959 order approving the notes. We think it clear from our 1929 report that we were not requiring any specific method of accounting for the sinking fund and computing rail transportation revenues:

> In arriving at the amount of such revenue, provision is made under item (j) of section 4 of this article for deducting certain profit and loss debit items therein enumerated, including surplus applied to sinking funds or set aside for investment in physical property. The effect of this will be to reduce the operating revenues of the railroad carriers which they derive from express traffic by amounts which are in reality appropriations of surplus. It should be understood that all that we are here passing upon is the plan for pooling and dividing earnings and *we are not passing upon other provisions of the contract, such as that mentioned above.* Nothing herein contained is to be construed as an expression of opinion upon the propriety of such deductions in connection with the determination of recapturable income under section 15a of the Interstate Commerce Act." 150 I.C.C. 423, 434. [emphasis added.]

The last sentence indicates that we had some question about REA following the accounting method that REA now

insists should have been followed. From a review of our own records and the new evidence received, we are satisfied that the Commission was adequately advised of the possibility of alternate methods of accounting for the sinking fund. This appears to be reflected in our report, which we view as permitting the method finally adopted.

In any event, the compliance or non-compliance with the 1929 report is peripheral to the central issues to which the district court directed our attention: whether the Non-Negotiable Debt is, in fact, "debt;" and whether the "1959 order was correctly or appropriately issued." We have reviewed the treatment of the Non-Negotiable Debt over a period of 40 years by the railroads, REA, third parties, including banks, and the Commission, and we have found a practically unanimous acceptance of this instrument as a debt. The evidence in support of the "debt" characterization includes action by businessmen and bankers involving substantial sums of money, opinions by attorneys knowledgeable in the field and action or forbearance by government agencies, including the Internal Revenue Service and ourselves. (Among our own actions in our 1928 report indicating our awareness of the system of interest-bearing advances, and our 1938 order authorizing an issue of notes to be repaid through this system.) Many persons and businesses have acted in reliance upon the Non-Negotiable Debt being debt. This would include the present owners of REA who purchased it for slightly over $2 million in 1969. It was clear from the purchase negotiations and terms that sellers and buyers assumed of the 1959 notes were valid. We are certainly not basing our decision on the fact that the new owners would receive a $27 million wind-fall, but we do mention it as one not insubstantial consequence of revoking our 1959 order. From the foregoing, we conclude that the Non-Negotiable Debt is in fact, debt.

We also conclude that our 1959 order approving the issuance by REA of notes in exchange for Non-Negotiable Debt

was not "incorrectly" or "inappropriately" issued due to any lack of consideration for the notes. In order to reach this conclusion, of course, we have considered and rejected one final argument of REA on this issue, the applicability of section 20a of the Act to the advances and the Non-Negotiable Debt. REA contends that a "security" was issued without prior authorization by the Commission. Therefore, REA argues, the unauthorized debt is void and the 1959 order falls for lack of consideration. We cannot agree. The Commission has consistently held that "advances" are not securities subject to the requirements of section 20a. In addition, the instruments cited by REA in support of its argument cannot be considered "evidence of indebtedness."

The status of "advances" under section 20a has been considered by us several times in the recent past. In 1971, we instituted a proceeding entitled "Ex Parte No. 275, Expanded Definition of Term 'Securities,' " in which we proposed to "expand" the term "securities" referred to in section 20a(2) to include a number of different financing instruments, including advances. After receiving public comment, we decided against this expansion, stating:

> Reports filed by committees of Congress relating to the Transportation Act of 1920 do not specify what would be included in the term "securities" other than the language of the act itself. Our review of the legislative history confirms the contention of the opposing parties that all references were limited to stocks, bonds, and promissory notes. Accordingly, it appears that the past interpretation of the term "securities" by this Commission to include stocks, bonds, notes and instruments that read like notes was essentially the fair and correct interpretation of section 20a of the act. 340 I.C.C. 817, 824 (1972).

Later in 1972, we reopened *Ex Parte No. 275* on our own motion and again proposed an expanded definition of the term "securities." An expanded definition was adopted on August 19, 1973, 344 I.C.C. 114, when we ordered, "That the

term securities as found in section 20a of the Interstate Commerce Act be *henceforth* interpreted as including, among other things, *** advances."

344 I.C.C. 114, 146. This order has never become effective, having been stayed on September 18, 1973, pending disposition of a substantial number of petitions for reconsideration. We made the following reference to advances to our 1973 report:

> Another type of transaction thus far not subjected to our "securities" jurisdiction is the advance between a carrier and another member of the same corporate family. These advances whether to or from affiliate or subsidiary companies, are effectuated through transfers of cash or property (which have included securities of noncarrier corporations), and are generally evidenced only by an accounting entry, but may be evidenced by a note or other writing 344 I.C.C. 114, 119.

We believe it is clear from the foregoing quotation from our decisions and the decisions themselves that, during the period when the advances in question were outstanding, 1929-1959, the Commission had consistently interpreted section 20a as not being applicable to advances. In fact, applicability of section 20a to the sinking fund arrangements was raised by REA with the Commission's Director of Finance in connection with the 1938 financing, and the Director advised REA that authorization under section 20a was not required. While we currently have pending a proceeding which may subject advances to the requirements of section 20a, any possible requirement to this effect would not be retroactive.

While advances, as such, may not come within the purview of section 20a it may, be contended, as REA does, that certain of the writings made in connection with the advances had sufficient attributes of a security to constitute such writing an "evidence of indebtedness" as referred to in the Act, First, it must be recognized that even rudimen-

tary accounting would require written notation to be made of any advance, as we pointed out in the last quotation above. As a matter of business practice, some evidence of the existence and amount of advances has ordinarily been recorded and made known to the other party. We have not in the past attempted to bring advances within 20a on the basis of such documentation of the obligation. Secondly, in order to come within the requirements of section 20a during the period the Non-Negotiable Debt was outstanding, the relevant writings would have to be "stocks, bonds, notes, (or) instrument that read like notes ***," as stated in our 1972 report above. Our attitude during the relevant perior is exemplified by the following quotation from our 1939 decision in *Lehigh Valley R. Co. Conditional Sale Contract,*

> *** It may be admitted that a contract of sale which contains provisions for payment is in a broad sense of the term, an evidence of indebtedness. So, also, is a check or memorandum invoice accepted by a carrier, but it will hardly be contended that the evidences of indebtedness last mentioned are securities within the meaning of section 20a(2). 233 I.C.C. 359, 365-6.

We also stated in the *Lehigh Valley* report that, "the provisions (of section 20a) were intended to apply to instruments negotiable or quasi-negotiable in character ***." 233 I.C.C. 359, 365. While we may be inclined to take a somewhat different view today, "since there have been major changes the type of financing methods utilized by carriers since the passage of section 20a ***." 340 I.C.C. 817, 818 (1972), we feel that the standards of *Lehigh Valley* are applicable to the advances and the Non-Negotiable Debt. Among the instruments cited by REA as constituting a "security," such as Mr. Lutz's letters, the accounting entries, the monthly "advices," and the statements or vouchers, none has sufficient attributes of a security to constitute an "evidence of indebtedness" within the meaning of section 20a of the Act. Furthermore, most, if not all of these writings, would ordinarily arise in connection with advances, a financing device considered to be beyond the reach of section 20a at the time the Non-Negotiable Debt was outstanding.

We are unable to share REA's assumption that a sinister motive was responsible for the railroads' expressed desire to structure the advances and the Non-Negotiable Debt in such a manner as to avoid the need for an application under section 20a. As long as unlawful acts are not being committed, it is a legitimate business purpose to arrange one's affairs to minimize regulation. We are equally unsympathetic to REA's speculation that the railroads' wish to avoid filing under section 20a arose from a fear of denial by the Commission. REA asks in its brief, "Would the Commission approve a scheme which could not be repaid under the circumstances then existing?" In fact, such a "scheme" was "approved," at least inferentially, when authorization was granted for the issuance of the 1938 notes with a sinking fund financed by advances which could not be repaid under the circumstances then existing.

II. The Antitrust Issues

As was stated above under "The REA Lawsuit," our initial concern with the REA litigation related solely to the nature of the Non-Negotiable Debt. However, during the course of the court's consideration of our request to stay its proceeding, we offered to explore the effect of our orders on the antitrust questions raised in the REA lawsuit. The 3-judge district court agreed to a stay, "on the assumption that (the Commission) will entertain all the proposals outlined in its memorandum ***." These included "whether as stated in (the Commission's) memorandum of November 17, 1972, 'the 1959 order, or indeed prior orders, did exempt the 1959 notes and the non-negotiable debt from the requirements of the antitrust laws' and, more specifically, whether

the notes were approved in furtherance of a section 5 transaction approved by the Commission.' "

> 4. Did the 1959 order or prior orders exempt the 1959 notes or the non-negotiable debt from the requirements of the antitrust laws?
>
> 5. Are there findings that should now be made by this Commission that would retroactively exempt the railroads from the requirements of the antitrust laws?

The antitrust issues with which we are concerned arise from the allegation by REA that section 10 of the Clayton Antitrust Act was violated through the creation and repayment of the Non-Negotiable Debt and the issuance of the 1959 notes without competitive bidding. (In an amended complaint, REA was alleged other violations of the antitrust laws, including conspiracy and price-fixing in contravention of the Sherman Antitrust Act. However, only the Clayton Act allegations were considered by Judge Metzner in his opinion and we believe no useful purpose would be served by our covering a broader range of issues.) Section 10 requires competitive bidding when a common carrier has "any dealings in securities, supplies or other articles of commerce" with another corporation which has one or more directors in common with the carrier. There were a number of directors serving both REA and a railroad during this period. The railroads' defense to these antitrust charges rests initially on section 5(11) of the Interstate Commerce Act which contains an exemption from the antitrust laws for certain actions performed in connection with a transaction approved by the Commission under section 5. Specifically, section 5(11) states, in part:

> *** any carriers or other corporations, and employees and any other persons, participating in a transaction approved or authorized under the provisions of this section shall be and they are hereby relieved from the operation of the antitrust laws and of all other restraints, limitations, and prohibitions of law, Federal,

> State, or municipal, insofar as may be necessary to enable them to carry into effect the transaction so approved or proposed by the Commission ***

The Commission's power under section 5(11) to confer exemption from the operation of the Clayton Act by its approval of transactions under section 5 has been confirmed by the United States Supreme Court. See *Minneapolis & St. Louis Ry.* v. *United States*, 361 U.S. 173 (1959).

The railroads' reliance on section 5(11) is based on Commission approval of the railroads' establishment and operation of REA pursuant to sections 5(1) and 5(2) of the Act. The Commission initially approved the railroads' ownership and control of REA under section 5(2) in 1929 and approved or examined under section 5(1) the standard express operating agreements between REA and the railroads in 1929, 1938, 1950, 1951, 1953, and 1959. The railroads contend that these actions by the Commission under section 5 operate to "relieve (them) from the operation of the antitrust laws." The railroads also contend that the regulatory authority of the Commission over REA and the railroads is so "comprehensive and pervasive," and such authority having been exercised "with respect to a relationship," that the antitrust laws may be preempted from application to the relationship. They cite *Hughes Tool Co.* v. *Trans World Airlines*, 409 U.S. 363 (1973), for the proposition that "close regulatory supervision under a broad statutory mandate serves to displace the antitrust laws."

A. The 1959 Notes

The 3-judge district court described its conception of the Commission's intention in this reopening as one of considering whether our orders had the effect of exempting the 1959 notes or the Non-Negotiable Debt from the antitrust laws, "and, more specifically, 'whether the notes were approved in furtherance of a section 5 transaction

approved by the Commission.' " The court thus emphasizes the question of the status under the antitrust laws of the 1959 notes, as opposed to the Non-Negotiable Debt. We also feel that the status of the 1959 notes is more appropriate for our consideration and will treat this question first.

To summarize again the relevant background of the 1959 notes, an application was filed by REA and the railroads on July 23, 1959, for approval of the pooling of traffic and earnings under section 5(1) of the Act. On August 18, 1959, a hearing was held on the application. On September 1, 1959, a second application, under section 20a of the Act, was filed for authority to issue the 1959 notes to evidence the Non-Negotiable Debt. The pooling application under section 5(1) was approved on September 21, 1959, and the securities application under section 20a was approved on September 25, 1959.

In his opinion in the REA Lawsuit, Judge Metzner succinctly sets forth REA's contentions, the law and his conclusions on this point:

> The order of September 25, 1959, approving the notes * * * expressly authorized REA to issue notes to its 66 creditor railroads in exchange for the Non-Negotiable Debt and held that this was "necessary and appropriate for and consistent with the proper performance by it of service to the public as a common carrier * * *." This is clearly a ruling by the Commission that the 1959 notes could be issued to specified companies without competitive bidding and that issuance of the notes was necessary to the joint venture approved initially in 1929.
>
> REA argues that the 1959 order cannot be interpreted as granting an antitrust exemption for the notes because the order was issued pursuant to § 20a under which the Commission had no authority to grant such an exemption. It is true that § 20a does not confer power to grant immunity from the anti-trust laws. *Denver & Rio Grande Western Railroad Co.* v. *United States,* 387 U.S. 485, 496-497, 87 S. Ct. 1754, 18 L. Ed. 2d 905 (1967). However, when securities are issued in conjunction with activity which has been approved under § 5 of the Act and the ICC specifically finds the issuance necessary to carry out the approved activity, the issuance will share the latter's immunization. *Denver & Rio Grande Western Railroad Co.* v. *United States, supra* at 497, 87 S. Ct. 1754; *Minneapolis & St. Louis Railway Co.* v. *United States, supra* * * *. 343 F. Supp. 851, 859.

We agree with Judge Metzner's conclusion that our two 1950 orders operated to confer on the 1959 notes the exemption from the antitrust laws provided by section 5(11). Judge Metzner was not, of course, passing on the correctness of our action, but the legal effect of our orders. After reconsideration of our 1959 orders and their antitrust effect of the 1959 notes, we are satisfied that the orders were correctly issued. We have no difficulty in concluding that "the notes were approved in furtherance of a section 5 transaction approved by the Commission," to quote the question of the 3-judge district court. REA's challenge to this conclusion is essentially based on the fact that the order approving the section 5 transaction did not refer to the notes, nor did the order authorizing the notes refer to the section 5 transaction. However, both applications were before this Commission for our consideration at the same time and the orders were issued within four days of each other. It is not conceivable that each application would have been treated in isolation from the other. This is particularly evident when we consider that a central purpose of the far-reaching 1959 changes in the REA-railroad arrangements was to pave the way for REA to become independent of the railroads and a necessary step toward this goal was the formalizing of REA's financial commitments. Any doubts we might have as to (1) the connection between the section 5 transaction and the notes, and (2) our consideration of this connection, are resolved by

the testimony of the president of REA at the Commission hearing on August 18, 1959, which is quoted above. In describing the plan for continued operation of REA, he testified that included within this plan was the issuance of notes to evidence the Non-Negotiable Debt. He stated that the application for authority to issue these notes would be filed "in two or three days." Based on the foregoing, we conclude that our order of September 21, 1959, approving a transaction under section 5, exempted the 1959 notes from the requirements of the antitrust laws. Our conclusion on this question is not altered by REA's numerous allegations of misrepresentations and omissions in the application which we find to be without any substantial basis.

B. The Non-Negotiable Debt

Before discussing the Non-Negotiable Debt, we will briefly refer to the question in our order reopening this proceeding which asked whether we should make findings retroactively exempting the railroads from the antitrust laws. For varying reasons discussed below, the parties contend we cannot, (or need not) make such findings. We believe we should not, for reasons also discussed below.

* * *

We have reviewed all evidence and arguments not mentioned in this report and find much of it beyond the scope of this reopening, particularly the matter relating to post-1959 events, and the remainder not sufficiently material to be discussed herein.

We conclude that our September 25, 1959, order was correctly and appropriately issued. In light of our discussion above, we believe that no further findings or conclusions are appropriate or necessary.

APPENDIX A

Order

At a Session of the Interstate Commerce Commission, Division 4, held at its office in Washington, D.C., on the 25th day of September, A. D. 1959.

Finance Docket No. 20812

RAILWAY EXPRESS AGENCY, INCORPORATED, NOTES

It appearing, That the Railway Express Agency, Incorporated, of New York, N.Y., by an application filed on September 1, 1959, applied for authority under section 20a of the Interstate Commerce Act to issue 5-percent nonnegotiable notes in the total principal amount of $27,637,053.80, and that no objection to the application has been offered;

It further appearing, That the applicant is indebted in the amount of $27,637,053.80 to 66 of its controlling railroad companies named in the application for funds advanced to it on open account to pay the principal amount due on the bonds and notes issued by it under authority granted in *Securities and Acquisition of Control of Ry. Exp. Agency, Inc., Notes,* 230 I.C.C. 478, decided December 20, 1938, respectively, and that this indebtedness bears interest at the rate of 4 percent per annum;

It further appearing, That, in order to evidence the above-described open-account indebtedness, the applicant proposes to issue to the said 66 railroad companies nonnegotiable promissory notes in the total principal amount equal to the amount owed to each carrier as shown in the application, will be dated October 1, 1959, will bear interest on the unpaid principal amount thereof at the rate of 5 percent per annum, payable semiannually on April 1 and October 1, and will be payable December 31, 1973; the notes will have the benefit of a sinking fund into which applicant will agree to pay on May 1, 1965, and on May 1 of each year

thereafter to and including the year 1973, an amount equal to 10 percent of its net income for the next preceding calendar year, such net income to be that remaining after provision for payment of all expenses and taxes, and distributions, if any, to carriers by railroad under Article 10, section 2(f) of the Standard Express Operations Agreement effective October 1, 1959; said notes will be prepayable in whole or in part without premium, provided, however, that each such principal payment shall, unless made from the above-described sinking fund, be paid pro rata to all holders of such notes and shall be made in a total sum of not less than $500,000; said notes will contain provision that no dividends will be declared or paid on applicant's capital stock so long as any of the notes are outstanding, and they will be subordinate to the obligations of the applicant to Morgan Guaranty Trust Company of New York and to The New York Trust Company, agent, represented by notes issued by applicant under authority granted in Finance Dockets Nos. 18674, 18774, 18984, 19961, and 20264;

It is ordered, and the said division so finds, that the proposed issue by Railway Express Agency, Incorporated, of 5-percent nonnegotiable promissory notes in a total principal amount not exceeding $27,637,053.80, as aforesaid (a) is for a lawful object within its corporate purposes and compatible with the public interest, which is necessary and appropriate for and consistent with the proper performance by it of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose:

It is ordered, That the Railway Express Agency, Incorporated, be, and it is hereby, authorized to issue to 66 of its controlling railroad companies named in the application nonnegotiable 5-percent promissory notes in a total principal amount not exceeding $27,637,053.80; said notes to be

issued upon the terms and conditions and for the purposes hereinbefore described;

It is further ordered, That, except as herein authorized, said notes shall not be sold, pledged or otherwise disposed by the applicant unless or until so ordered or approved by this Commission.

It is further ordered, That the applicant shall report concerning the matters herein involved in conformity with the order of the Commission, by division 4, dated August 9, 1946, as amended, respecting applications filed under section 20a of the Interstate Commerce Act (49 CFR 56.4 and 56.6); and

It is further ordered, That nothing herein shall be construed to imply any guaranty or obligation as to said notes, or interest thereon, on the part of the United States.

By the Commission, division 4.

HAROLD D. MCCOY,
Secretary.

[SEAL]

APPENDIX B

71 Civ. 4278

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

REA EXPRESS, INC., *Plaintiff*,

v.

THE ALABAMA GREAT SOUTHERN RAILROAD COMPANY, ET AL., and THE UNITED STATES OF AMERICA, *Defendants.*

Before FRIENDLY, Chief Judge of the Second Circuit, KNAPP and GRIESA, District Judges.

Memorandum and Order

PER CURIAM:

Since Counts III and VII of the second complaint contain allegations which can be read as calling in question the validity of an order of the Interstate Commerce Commission, the motion of the Commission for leave to intervene as a party defendant and to appear with like effect as if named as an original party defendant is granted, 28 U.S.C. § 2323, to the extent that the Commission may appear with like effect as the United States.

The Commission has also moved, in line with a vote taken on August 10, 1972, to stay all further proceedings herein "pending the Commission's reconsideration of its order of September 25, 1959" in F D. No. 20812, *Railway Express Agency, Inc., Notes.* While this motion had been stricken from the list of options to be argued on December 19, the Commission appealed from that ruling of the single judge and argument was in fact heard. The Commission states, in a memorandum of September 5, 1972 in support of its motion, that "[o]n reconsideration the Commission will entertain whatever facts and arguments the parties desire to bring to its attention regarding the 1959 order." We

read this as meaning what it says, namely, that reconsideration will be given not only to the suggestion, advanced in the Commission's memorandum, that the non-negotiable debt perhaps "in fact represented but railroad equity in REA," which has aroused understandable concern on the part of the railroad defendants, but also whether, in the Commission's words, "the 1959 order was correctly or appropriately issued" on the contrary assumption and, in addition, whether as stated in its memorandum of November 17, 1959 notes and the non-negotiable debt from the requirements of the antitrust laws" and, more specifically, "whether the notes were approved in furtherance of a sction 5 transaction approved by the Commission." Our action on the Commission's motion is predicated on the assumption that it will entertain all the proposals outlined in its memoranda and, indeed, any others that may be appropriate.

The defendant railroads and, in respect to the suggestion concerning antitrust immunity, the United States contends that the Commission is without power to reconsider, clarify, revise or supplement its orders after so many years. We agree that its right to do so is by no means plain. See Davis, Administrative Law Treatise § 18.09 (1958 ed. & 1970 Supp.). However, we see no reason to pass on the Commission's powers until we know, as neither we nor it now can know, namely, what it desires to do. Moreover, the parties seem to agree that, even if we should deny the Commission's motion for a stay, it might very well proceed with a reconsideration, whether lawfully or unlawfully, either while this action is pending (although perhaps we could enjoin that if we deemed that course to be proper), or after its conclusion. Economy of administrative and judicial time will be furthered by allowing the Commission to engage now in whatever reconsideration, clarification, revision, or supplementation it considers to be proper and lawful. Such action might also lead to further amendment of the pleadings, which may cast the problem of three-judge

court jurisdiction in a new light. It should be clear that in allowing this, we are making no decision on what the Commission may lawfully do.

ORDER

At a General Session of the INTERSTATE COMMERCE COMMISSION, held at its office in Washington, D C., on the 9th day of January 1973.

Finance Docket No. 20812

RAILWAY EXPRESS AGENCY, INC., NOTES

It appearing, That by order of September 25, 1959, as amended, this Commission authorized the issuance of promissory notes by the Railway Express Agency Inc., to a number of railroads in the amount of $27,637,053.70; the notes were to be issued in exchange for certain "non-negotiable debt" on the express company's books in the same face amount;

It further appearing, That on September 30, 1971, REA Express, Inc., as successor to the above-named company, commenced an action in the United States District Court for the Southern District of New York entitled *REA Express, Inc.* v. *The Alabama Great Southern Railroad Company, et al.,* 71 Div. 4278, alleging that the railroad companies, which had until 1968 or 1969 exercised voting control over REA, *inter alia,* (1) violated section 10 of the Clayton Act, such as for example in creating the non-negotiable debt, (2) violated section 20a of the Interstate Commerce Act by causing the issuance of a security by REA without approval of the Commission, and thereafter voided tht 1959 notes under section 20a(11) by terminating the standard operating agreement, (3) caused the issuance of the 1959 notes which are void for lack of consideration, (4) voided the 1959 notes by breaching an implied covenant to retain the standard operating agreement in force, (5) breached fiduciary obligations to REA, (6) engaged in price

fixing in violation of section 1 of the Sherman Act, 15 U.S.C. 1, and (7) violated section 10 of the Clayton Act by issuing the 1959 notes without competitive bidding.

It further appearing, That upon being advised of the pendency of the aforesaid suit, the questions that had been raised concerning our authorization of REA in 1959 to issue promissory notes to its railroad parents and the course of events extending back to 1929 which had led to that authorization, and the decisions of District Judge Metzner of June 5, 1972 (343 F. Supp. 851), we voted on August 10, 1972, to reopen the above-entitled proceeding for reconsideration, but to enter no order until the Court had been apprised of our vote and had been given an opportunity to entertain a motion to defer further proceedings;

It further appearing, That on December 20, 1972, a Three-Judge District Court, composed of Circuit Judge Friendly and District Judges Knapp and Griesa, enter an order granting motions made by this Commission to intervene in the court proceeding and to stay further court proceedings on the merits of REA's complaint;

It further appearing, That the District Court's stay is conditioned upon our proceeding with expedition in view of the fact that the notes in issue mature on December 31, 1973; and hence the stay will expire on May 1, 1973, unless by motion made not later than April 13, 1973, the Commission shall show good cause for an extension; accordingly;

It is ordered, That this proceeding is hereby reopened for reconsideration, and such hearing as the need therefor may appear,

It is further ordered, That REA Express, Inc., and the railroads and their assignees listed in the appendix hereto are hereby made parties to this reopened proceeding;

It is further ordered, That REA Express, Inc., and the parties set forth in the appendix hereto, shall file with the

Commission a verified original and 15 copies of each of the affidavits bearing on the merits of REA's complaint, which they have already filed in the district court, on or before the expiration of 20 days from the entry of this order;

It is further ordered, That the parties to this reopened proceeding shall on or before the expiration of 30 days from the entry of this order file an original and 15 copies of briefs, verified statements of facts, and proposed findings and conclusions, relating to whatever matters the parties shall desire the Commission to consider or decide in this reopened proceeding; the parties shall, without limiting the matters that may be raised, address themselves to the substance of the following issues and the Commission's authority in the matter:

1. Did the non-negotiable debt represent the build-up of railroad equity in REA by its railroad parents?

2. Did REA's repayment of that debt or interest thereon represent a return of an equity capital?

3. If the answer to number 1 or 2 is "yes," what legal and practical consequences should flow from that finding?

4. Did the 1959 order or the non-negotiable debt from the requirements of the antitrust laws?

5. Are there findings that should now be made by this Commission that would retroactively exempt the railroads from the requirements of the antitrust laws?

It is further ordered, That the parties hereto may on or before the expiration of 50 days from the date of this order file reply briefs, verified statements of facts, and proposed findings and conclusions in response to the initial briefs and other papers filed herein;

It is further ordered, That any party requesting oral hearing shall set forth with specificity in his initial or reply brief the need therefor and the evidence to be adduced;

And it is further ordered, That copies of this order shall be mailed to REA Express, Inc., to the parties named in the appendix, to the governors of each of the contiguous States, and upon the Attorney General of the United States; and that a copy of this order be delivered to the Director, Division of Federal Register, for publication in the Federal Register.

By the Commission.

ROBERT L. OSWALD,
Secretary.

(SEAL)

APPENDIX

The Alabama Great Southern Railroad Company
The Atchison, Topeka and Santa Fe Railway Company
The Baltimore & Ohio Railroad Company
Bangor & Aroostock Railroad Company
Boston & Maine Railroad
Burlington Northern, Inc.
Canadian National Railway Co.
Central of Georgia Railway Company
Central Railroad Co. of New Jersey
The Chesapeake & Ohio Railway Company
Chicago & Eastern Illinois Railway Co.
Chicago, Milwaukee, St. Paul & Pacific Railroad Company
Chicago & Northwestern Railway Co.
Chicago Rock Island and Pacific R.R. Co.
The Cincinnati, New Orleans & Texas Pacific Railway Co.
The Cleveland, Cincinnati, Chicago & St. Louis Railway
Clinchfield Railroad Company
The Colorado & Southern Railway Company
The Delaware & Hudson Railroad Company
The Denver & Rio Grande Western Railroad Company
Erie Lackawanna Railway Co.
Florida East Coast Railway Co.
Fort Worth & Denver Railway Company
Gulf Mobile & Ohio Railroad Company

Illinois Central Railroad Co.
The Kansas City Southern Railway Company
Lake Superior & Ishpeming Railroad Company
Lehigh Valley Railroad Co.
Louisville & Nashville Railroad Company
Maine Central Railroad Company
The Michigan Central Railroad Company
Missouri-Kansas-Texas Railroad Company
Missouri Pacific Railroad Co.
The New York, New Haven and Hartford Railroad Company
Norfolk and Western Railway Company
Penn Central Transportation Co.
Reading Company
Richmond, Fredericksburg & Potomac Railroad Company
St. Louis-San Francisco Railway Co.
St. Louis Southwestern Railway Company
St. Louis Southwestern Railway Company of Texas
Seaboard Coast Line Railroad Co.
Soo Line Railroad Company
Southern Pacific Transportation Company
Southern Railway Company
Spokane, Portland & Seattle Railway Company
The Texas & Pacific Railway Co.
Union Pacific Railroad Co.
The Western Railway of Alabama
Western Maryland Railway Co.
Bankers Trust Company (Pitt & Co. and Salkeld & Co.), as assignee of Maine Central Railroad Company and the New York, Susquehanna Western Railroad Company
Pennsylvania Coal Co., as assignee of Delaware Lackawanna and Western Railroad Company and Erie Railroad Company
United States of America, as assignee of the Central Railroad Co. of New Jersey

Order

At a General Session of the INTERSTATE COMMERCE COMMISSION, held at its office in Washington, D.C., on the 28th day of July 1975.

Finance Docket No. 20812

RAILWAY EXPRESS AGENCY, INC., NOTES

It appearing, That, by order of January 9, 1973, the Commission reopened this proceeding for reconsideration, and such hearing as the need therefore may appear, and

It further appearing, That the Commission, on the date hereof, has made and set forth its report in this proceeding setting forth its conclusions and findings and its reasons therefor, which report is hereby referred to and made a part hereof:

It is ordered, That the January 9, 1973 order of the Commission in this proceeding be, and it is hereby, vacated, and that these proceedings be, and they are hereby, discontinued.

And it is further ordered, That this order shall become effective 35 days from the date this order is served.

By the Commission.

ROBERT L. OSWALD,
Secretary.

(SEAL)

Order

At a General Session of the INTERSTATE COMMERCE COMMISSION, held at its office in Washington, D.C., on the 11th day of February, 1976.

Finance Docket No. 20812

RAILWAY EXPRESS AGENCY, INC., NOTES

Upon consideration of the record in the above-entitled proceeding, including the report and order of the Commission, served August 29, 1975, vacating the order of January 9, 1973 reopening this proceeding of the petitions filed September 29, 1975, by REA Express, Inc. for reconsideration, further hearing and oral argument and of the reply thereto by certain railroad parties, filed October 20, 1975; and

It appearing, That REA Express, Inc. (REA) alleges, among other things, (1) that the non-negotiable debt or advances created between certain railroads and REA was improper because it was not provided for under the terms of the pooling agreement and was a security requiring Commission authorization under Section 20a of the Interstate Commerce Act; (2) that the promissory notes authorized in this proceeding by order of September 25, 1959 (hereinafter the 1959 Notes) were improperly approved because the non-negotiable debt did not supply adequate consideration, and such notes and the attendant application did not fulfill the requirements of Section 20a; (3) that the issuance of the 1959 Notes was not in furtherance of the revision of the pooling agreement authorized by order of September 21, 1959 and was not immunized from the effect of the antitrust laws by Section 5(11) of the Act because of such authorization; and (4) that certain misstatements, comments and evidence in this proceeding and the Commission's report and order on further consideration, served August 29, 1975, have prejudiced REA's case and require additional evidentiary proceedings or oral argument;

It further appearing, That the non-negotiable debt, although not specifically authorized by the Commission's report and order of February 11, 1929, *Securities and Acquisition of Control of Ry. Exp. Agency,* 150 I.C.C. 423, approving the pooling agreement, was within the permissible bounds of the Commission authorization, that the Commission was fully informed that the outstanding bonded indebtedness might be retired in a manner other than that provided for in the pooling agreement, and that the character of the non-negotiable debt or advances was not such as to be a security within the meaning of Section 20a at the time of its creation;

It further appearing, That the application for the issuance of the 1959 Notes disclosed all facts insofar as they were material to such authorization, that on the basis of this record, the issuance of such notes was for a lawful object within REA's corporate purpose, and compatible with the public interest which is necessary or appropriate for or consistent with the proper performance by REA service to the public as a common carrier, and which would not impair REA's ability to perform that service, and was reasonably necessary and appropriate for such purpose; and that, as the non-negotiable debt was a valid debt, adequate consideration existed for such notes;

It further appearing, That, as the 1959 Notes were properly authorized pursuant to Section 20a, that approval and the Commission's approval in *Express Contract, 1959,* 308 I.C.C. 545 operated to confer on the 1959 Notes the exemption from the antitrust laws provided by Section 5(11) because the notes were approved in furtherance of a Section 5 transaction approved by the Commission, see *Minneapolis & St. Louis Ry.* v. *United States,* 361 U.S. 13, 190-191 (1959); and

It further appearing, That REA's allegations that the Commission misstated REA's position on the debt/equity question, that the improper introduction of expert testimony

by certain railroad parties deprived REA of a right to rebuttal, that the official notice of certain Commission rate cases was improper because no opportunity was given to rebut the findings in those cases and that the National Transportation Policy requires the voiding of these notes are allegations not supported by law or the evidence of record;

It further appearing, That said petition for reconsideration sets forth no material facts or arguments in addition to those previously considered in this proceeding; that the conclusions and findings in the report and order of August 29, 1975 are adequately supported by the evidence of record; that there has been presented no errors of fact or law with respect to the matters complained of by REA Express, Inc. and that no showing has been made warranting reconsideration of said order; and

It further appearing, That in light of the above, no good cause has been shown why further hearings or oral argument are necessary;

It is ordered, That the petitions for reconsideration, further hearing and oral argument be, and they are, hereby denied, and

It is further ordered, That the order entered July 28, 1975, shall be effective 20 days from the date this order is served.

By the Commission.

ROBERT L. OSWALD
Secretary

(SEAL)

NOTE: This is not a major Federal action significantly affecting the quality of the human environment, within the meaning of the National Environmental Policy Act of 1969.

REA Exhibit 66

Finance Docket
No. 20812

Summary of the Terms of Lehman Brothers' Offer To Purchase Railway Express Agency, Incorporated

Lehman Brothers or individual partners of the firm, with some investor-clients of the firm possibly participating, will purchase from the owning railroads all outstanding shares of Stock of Railway Express Agency, Incorporated, hereinafter called REA, at the price of $500 per share, payable on the closing date. No buyer will be a carrier under any Federal, state or local law, nor a person who has control of such a carrier, and Lehman Brothers is willing to enter into an agreement that no stock will, for a reasonable time, be sold to any trucker, forwarder, or other person to whom the present stockholders might take exception. The Buyers have expressed the intention that REA will continue to conduct an express business and represented that the purchase is not for liquidation.

Upon the sale of the Stock REA will, subject to required regulatory approvals, execute non-assignable Notes covering the amount of the advances to each stockholding railroad. Two Notes in equal amount will be issued to each railroad. Each will bear interest at 4%, and one will mature on December 31, 1959 and the other on December 31, 1960. The maturities are subject to possible postponement in the event that substantial additional liabilities of REA now unknown to the parties to the transaction should be discovered before December 31, 1960. If this should happen the due date of an amount of principal of the Notes equal to the amount of the newly discovered liabilities shall be postponed until December 31, 1965. Lehman Brothers is fully aware of the unrecorded and contingent liabilities of REA now known to REA and the railroads but not reflected on REA's Balance Sheet, so these would not come within the terms of the foregoing provision.

So long as any Notes are outstanding the proceeds of the sale of REA property not replaced and the proceeds of any mortgage of pledge of REA property will be applied to the payment of such Notes. Lehman Brothers has stated that they are satisfied that the program is feasible and that they have no doubt as to the ability of REA under the proposed new ownership to finance the Notes at maturity either by refunding or otherwise.

The Standard Express Operations Agreement will, subject to the required regulatory approvals, be amended on the closing date but effective as of April 1, 1959. It will provide for full freedom of routing by REA for the balance of the year, both as between different railroads and between a rail carrier on the one hand and a motor carrier on the other. For the period April 1 to December 31, 1959, each will be paid a fixed amount per actual assigned car-foot mile of express service furnished by it. This amount will be approximately the same per assigned car-foot mile as such road would have received on the basis of REA's Annual Budget for 1959, First Quarterly Revision, dated April 14, 1959. After the end of the year REA will determine the amount of Rail Transportation Revenue which would have been paid to all railroads for the period April 1 to December 31 in the absence of the amendment. If this amount is more than 110% of the total amount actually paid in accordance with the amendment, the excess will be divided equally between the railroads and the Express Company and each railroad will receive the pro rata share.

All provisions relating to railroad obligations on termination of the Agreement will be removed therefrom and the Agreement will terminate completely on December 31, 1959. REA, under the new ownership, will negotiate with the railroads now handling a substantial amount of express traffic with the view of entering into a new contract or contracts as of January 1, 1960, covering the continued

handling of express, but no obligation is placed on any railroad to execute such a contract. REA will negotiate for a standard agreement with all roads or with groups of roads. if this is feasible, but will be prepared to negotiate on a road by road basis if necessary.

REA Exhibit 64

Finance Docket
No. 20812

Union Pacific Railroad Company
Controller's Office

May 4, 1959

File.....

May 1, 1959

Mr. William B. Johnson, President
Railway Express Agency Incorporated
219 East 42nd Street
New York 17, N.Y.

Copy to Messrs. Bennett and Burns*

Dear Mr. Johnson:

As suggested in your letter of April 27th, I here record, in as short a compass as possible, my further consideration of the Lehman Bros. proposal.

Southern is very much interested in a proposal that will relieve it from liability under the existing agreement—and of responsibility for continuing the service. We would like to become a free agent as to whether or not we continue in the express business. I take it there is general agreement with this objective.

---

* A handwritten note.

The Lehman Bros. proposal, by eliminating Article 17 of the Uniform Contract, and indeed by terminating the contract December 31, 1959, would have the effect of relieving the contracting railroads of Agency liability incurred after the date of amendment, should such excess still exist after the termination. In form this relief could be accomplished by an affirmative release by the Agency and by each of the contracting parties. It is precisely at this point that we run into the problem of third parties who have relief on our contract. I have not been able to find a method of being relieved of the commitment as to existing liabilities.

Similarly, I would cherish the possibility of being relieved of whatever my responsibility is to perform an express business. Should we have the Express Agency, by contract, assume every bit of the rail carriers' responsibility for performing express service, whatever it is, and seek the approval of the I.C C. to this transfer of the responsibility?

The problem is that if we continue to have the responsibility, as it has so far been interpreted, or as it may be further provided by interpretation or legislation, we will take a serious step if, by selling to another, we create an adversary who will demand from us before public authority at least line haul service at rates which we do not regard as compensatory. I would rather stay where I am than to take this step.

Perhaps we should seek to have the Agency agree that it will not dispute with us about such matters before public authority, agreeing to accept our tariffs or to take the business elsewhere.

Lehman Bros. has a superb financial reputation. We will be completely justified in making a reasonable deal with them. On the face of the deal as they have explained it, we are presented with a great opportunity. However, they have insisted on making quite clear their lack of experience with the express business and their lack of familiarity with

detail. We are the parties who know about the business. We have the responsibility to inquire whether it will have a reasonable opportunity to succeed.

A diligent examination has left me convinced that the proposed transaction must be presented to the Commission for approval and that a hearing will be required. The Commission itself may decide that the issues involved are of such importance that it should set the matter down for hearing, if for no other reason than to inquire as to what the arrangement will be in 1960 and thereafter. Other interested parties include our creditors, labor organizations, forwarders and shippers. It is inconceivable to me that we will not have a hearing.

If we have a hearing it will probably require some 18 months or more to resolve the questions that will be raised. This makes discussion of the amended contract for the period from the date of execution to the end of 1959 completely unnecessary since it will never operate. It raises the most serious questions as to the December 31, 1959 and December 31, 1960 maturities. Perhaps this is why the proposal involves a right of Lehman Bros. to withdraw should final approval not be had by August 31, 1959.

I think I can say quite categorically that final approval will not be had by August 31, 1959 and I wonder whether others might not share my lack of enthusiasm for entering into an option agreement. To be sure the option is said to run both ways but I have not supposed that anyone was looking for a false start so that we might have delay, and resulting continuance of the present unsatisfactory situation. Certainly this has not been my objective. A deal which involves the right to withdraw, with what can only be regarded as very sound incentives to withdraw, against a deadline which cannot be met, is no deal at all except possibly for the purpose of delay and renegotiation.

The proposal involves our selling our name to another and creating an adversary before public authority as noted

above. It will turn over to an outsider an important segment of labor negotiations. It will run the risk of creating a situation where for sound business reasons the business would be liquidated under circumstances which might be inconsistent with our larger interest, as indeed we have thought it would be. I agree it would perhaps not be as bad as liquidation now, but the only improvement for me is in the element of time.

I have thought further about the factor of public financing by the Agency as proposed. Since the very basis of the Agency's credit has been the Uniform Contract, which it is proposed to terminate, I must say that I entertain a very grave doubt that the Commission would approve public financing in the light of the Agency's uncertain future. It is true that public financing is not the only possibility for paying off the notes to the railroads. Some of the alternatives amount to no more than using the existing contract, and as amended, to sell property to the railroads, using the proceeds to pay off the railroad advances. This could fall quite unevenly.

There has been reference to conditions and limitations which the Commission might impose which would make the transaction quite unacceptable to both Lehman Bros. and the railroads. On the other hand, backing out at that point might prove to be quite embarrassing, if not impossible.

Many of the points I have referred to apply with equal force to any proposal to sell the stock of the Agency. An improved situation would obtain if the sale was to an experienced operator. However, as I have indicated in the past, in my opinion, a better procedure would be to hire an experienced operator and work ourselves out of a difficult situation as best we can.

I come now to a discussion of the various proposed agreements. I will not dwell in detail on the Uniform Contract amendments because, as I have indicated, I don't see how

the amended contract could ever be effective within its term. I do believe that the amendments are incomplete in certain respects which I have pointed out to Bill McLean who is a member of the Drafting Committee.

As to the stock purchase agreement, it seems to me that we are asked for representations which require determinations by quite a number of separate corporate stockholders whereas a simpler procedure would be to have these questions resolved during the time between now and May 15th. I refer to the sellers' representations, Paragraph numbered 1. We would need to have a look at the various exhibits referred to throughout the stock purchase agreement before we could possibly make the representations requested. Even then, each stockholder will have to satisfy himself separately on a great deal of detail. Take, for example, Representation 1-(d). How can Southern make a reasonable representation on this amount of detail? This applies with equal force to (e), (f), (g) and other representations.

In form, Representation (i) requires me to certify the title of other stockholders. I do not believe I could ever do this. I am mystified as to what the liability may be as referred to in the second sentence of Paragraph numbered 2 in the event there is no deal because there is no unanimous agreement. The second word in the second line of page 5 of the draft is "earlier." Does that mean we might go ahead and close the deal in advance of approval? I have indicated I believe we would probably not have approval by August 31, 1959.

Should Paragraph numbered 4 include a representation that the buyer is not controlled by a carrier? In Paragraph numbered 8 there is reference back to not fulfilling a negative condition. I think I know what is meant but the interplay is quite complicated and I am not sure how it would come out in an adversary procedure. Further in this para-

graph there is reference to withdrawal but no time limit. I had the idea that everybody could get out if everything was not done by August 31, 1959 but I cannot get this out of the document. Similarly, I had understood that the representations and warranties would survive to the end of 1959 whereas paragraphs numbered 9 and 10 refer to December 31, 1960. Incidentally, I believe that in the last two lines on page 8 we find the precedent for what may be a series of postponements and renegotiations.

I have said before that I am not going to be a "hold out" on this matter. If I cannot convince the other Board members on some items of substance by May 15th, I will be surprised, but I will decide that I must be wrong.

Most sincerely,

Vice President

Copy—Board of Directors R.E.A. (3)
Mr. Stanfield Johnson
Mr. C. M. Roddewig

REA Exhibit 74

Finance Docket
No. 20812

RAILWAY EXPRESS AGENCY
INCORPORATED

Office of Vice President, Administration and Finance
210 East 42nd Street
New York 17, N. Y.

C. J. JUMP,
Vice President

July 31, 1959

Mr. David C. Bevan,
Chairman, Finance Committee,
c/o The Pennsylvania Railroad Company,
Six Penn Center Plaza,
Philadelphia 4, Pa.

Dear Mr. Bevan:

Responding to your joint letter of July 28 to members of the Finance Committee:

Bonds calling for an interest rate of 5% were issued in the sum of $32 million in 1929. Amounts required to meet the semi-annual maturities were advanced to the Agency by the stockholders. When one-half of those bonds had been paid off the remaining bonds were called and were replaced by serial notes on which the interest rates ranged from 3/8% to 2.5%. The stockholders continued to advance funds for retirement of the notes.

Interest payments on the advances received from the stockholders have been made as follows:

5¼%	March 1, 1929 to February 28, 1930
6%	March 1, 1930 to December 28, 1938
5%	December 29, 1938 to May 31, 1955
4%	June 1, 1955 to date

Fixing at 5% the interest rate on the notes to be issued to the stockholders would result in an increase of 25% in the interest charges. This would be equivalent to some $235,000 a year and to that extent would reduce the amount which otherwise would be available for payment to the railroads for hauling express.

Under the Amended Express Operations Agreement now before the Interstate Commerce Commission for approval the Agency ultimately will assume fixed obligations to the railroads for the transportation of express traffic. I would hope that the railroads as stockholders will not make it too difficult for the Agency to meet the payments to the railroads as contractors when the agency begins to operate on more nearly an arms length basis.

It is suggested that the notes to be issued to the stockholders provide for interest payments at the prime rate in effect during each interest period; that if the prime rate should change the change in the rate to be paid to the stockholders be made as of the beginning of the interest period nearest the date of the change in the prime rate. This would bring about an immediate increase of ½ of 1% in the interest payments because the prime rate now is 4½% as compared with 4% now being paid by the Agency.

I concur in your proposal concerning the establishment and operation of a sinking fund. However, I believe the sinking fund provision should be 10% of the disposable income, i.e., 10% of the Agency's net after taxes.

I believe also that the notes to stockholders to cover amounts advanced by them which were required and used by the Agency to purchase the properties of the Agency's predecessor should be subordinated to any and all other

indebtedness of the Agency except, perhaps, to the extent of the sinking fund.

Yours very truly,

/s/ C. J. JUMP
Vice President.

cc—Messrs. W. R. Grant
E. Spencer Miller
L. F. Ormond
John B. Reid
R. G. Rydin

BEFORE THE INTERSTATE COMMERCE COMMISSION

FINANCE DOCKET NO. 20812

Railway Express Agency, Inc., Notes

Verified Statement of L. John Eichner

On Behalf of REA Express, Inc.

My name is L. John Eichner and my business address is 230 Park Avenue, New York, New York. I am a member of the firm of Simat, Helliesen & Eichner, a professional consulting firm which engages in economic and transportation studies for various agencies of the Federal Government, for state and municipal governments and their agencies and for industrial and transportation companies.

STATEMENT OF QUALIFICATIONS

By way of background, I graduated in 1942 from The Johns Hopkins University with a degree in economics. From 1942 through 1945, I was on active duty with the Air Force, and subsequently remained in the Air Force Reserve, with the military occupational specialty of Transportation

Officer and the rank of Lt. Colonel, until I entered the retired reserve in 1966.

From 1945 until 1953, I was employed by Capital Airlines in New York and Washington, D.C. and participated in the establishment of one of the first air freight services in the United States. I was also responsible for the mail and express activities of the company and served as chairman of the industry mail committee during this period, as air postal transportation expert for the U.S. Senate Postal Advisory Council, and on various industry committees. From 1953 until 1961, I was vice president of Texas International Airways, and was responsible for all of the ground activities of this company, including marketing, passenger and cargo services, passenger reservations, scheduling, tariffs and advertising. Throughout this period I represented the local service airline industry as their representative on the Board of Directors of Air Cargo, Inc. in connection with the provision of trucking services for air freight, on the Airlines' Negotiating Committee in connection with the negotiation of the industry contracts for express services, as chairman of the industry's Air Express Committee, and as a member of the Air Traffic conference.

From 1961 until 1966, I was in charge of long range planning for American Airlines. My department, and personnel under my direct supervision, performed complete economic and cost analyses of various passenger services, under varying conditions of carriage, of various reservations systems, of varying competitive services of all modes. The Equipment Cost Analysis Section was made a part of our Long Range Planning Department for the later years of this period. Various computer reports of costs of providing passenger services by trips and city-pairs were designed and developed by my department.

In 1966 I became a member of the firm of Simat, Helliesen & Eichner, and since then I have participated in or directed major studies of all modes of transportation during

the past eight years. Among these studies have been those of the comparative costs of rail and water transportation for domestic and export shipments, of cost of freight forwarder services, of costs of truck pickup and delivery services, of costs of handling passengers for many airlines under many varying conditions, of cost of containerization of small shipments moving by rail and of alternate methods of providing transportation for these shipments, of passenger load factor behavior and the application of load factor standards to passenger rate making, of costs of passenger transportation in the Northeast Corridor, of the effects of density upon costs of trucking and handling of surface and air cargo, of the markets and costs of supplemental airlines for passenger charters, and of rail commutation services and their peaking problems, among others. Many of our studies have involved statistical costing techniques where it was proper to make use of such techniques and the data permitted their use.

Our firm was retained by the Association of American Railroads to conduct a study for the purpose of determining the nature and amount, if any, of costs incurred by Amtrak in providing, on a space available basis, free transportation to home road pass riders and reduced rate transportation for other eligible personnel.

Because our firm is one of the three firms designated to perform "quick response" studies for the U.S. Department of Transportation in connection with regulatory and study problems relating to all modes of transportation, we were selected several months ago to perform a Rail Branch Line Abandoment Study and, prior to that, a study of Selected Aspects of Rail Carrier Economics. I have spent much of my time during the past four years preparing studies on behalf of the entire airline industry in the first industry-wide investigation of express rates and costs, including the allocation and separation of air and ground (truck, rail & terminal) expenses, and in the preparation of studies for

the Metropolitan Transportation Authority of New York State, of which the largest was one of a proposed new rail passenger line.

Through our Canadian affiliate, located in Calgary, Alberta, we have participated in various studies concerning the transportation of cargo and passenger traffic in Canada and the Arctic regions. I have testified, as have my associates, to the results of many of our studies before regulatory bodies and in Federal Courts.

Financial Gains to the Railroads

The purpose of this statement is to summarize the study which was performed under my direction and supervision of the nature, procedures and resulting gains to the railroads from 1929 to 1970 as a result of railroad ownership and manipulation of the Express Company.

A review was made of the operating relationship between REA's predecessor, the American Railway Express Company and the railroads and also practices under the Express Operations Agreements of 1929, 1954 and 1959.

Included is a description of many of the practices the railroads adopted to increase their revenues although they were detrimental to REA. Estimates are made of the net impact upon REA's equity and operating results. Several examples are presented which demonstrate that the railroads practices were not in accord with directives and understandings of the Commission. As a result both the financial health of REA and the interests of the widespread public users of REA services were penalized.

For a cash outlay of $100,000, the railroads were able to acquire and own REA, during the period 1929-1970, and to benefit tremendously in different and significant ways mostly through accounting changes. From 1929 until the present, actual cash gains were realized by the railroads by changes from the procedures of the various Express Operations Agreements and by unduly taking money out of the express business that should have remained with the

express business. In addition, the railroads escaped from substantial liabilities by the formation of REA in 1929 and by the termination of the 1954 Express Agreement in 1959. Finally, the railroads diverted from REA into railroad assets, in the form of "advances" and interest thereon, large sums of money, that should not have been so reported. These actions against REA and the resulting dollar impacts are discussed below.

Misrepresentation of Express Income Earned by the Railroads in Rate Cases

1. Under the operations agreement approved by the ICC on February 11, 1929 (150 ICC 423), the items enumerated by Article V as properly deductible before determining railroad transportation revenues included all operating expenses of REA, interest, and also Accts. 328 "Income applied to sinking fund and other reserve funds" and 409 "Surplus applied to sinking and other reserve funds."[1] The railroads did not permit REA to use Accts. 328 and 409 as a deductible item in determining railroad transportation revenues, as contemplated by the agreement presented to the Commission for approval and approved by the Commission. Instead, the railroads provided for the payment of the sinking fund requirements in respect of the $32 million in serial gold bonds placed with J.P. Morgan & Co. and Kuhn, Loeb & Co. by means of ficticious "advances" from the railroads to REA which were treated on the books of REA and the railroads as loans bearing interest at rates generally in excess of the 5% coupon rate of the serial gold bonds. Interest on the so-called "advances" was charged to Acct. 323—Interest on funded debt—and

[1] The Uniform System of Accounts for Express Companies, issued on July 1, 1914, states that Acct. 409: ". . . shall include amounts definitely appropriated from surplus and applied to sinking and other reserve funds; and allotments or payments of definite amounts from surplus into sinking and other reserve funds under the terms of mortgages, deeds of trust, or other contracts that provide for such allotments or payments."

the amounts so charged were deducted in deriving the amounts payable to the railroads for transportation services.

Mr. Mahaffie, Director of Finance of the Commission, carefully questioned two of the railroad lawyers discussing proposals for paying off the bonds at a meeting on January 11, 1929, to assure himself that nothing of what was being proposed would be injurious to the public interest. "He said he was not a rate man, but did wish to have anything in this proceeding that would afford a claim that it should have been looked at from a rate standpoint." They assured him that it would have no rate effect whatever. (Memorandum of Conference with Mr. Mahaffie, Director of Finance, January 11, 1929. Attachment 15)

In view of the changes which the railroad directors made in what the Commission approved, however, the effect was to constitute a serious burden on REA as well as on the shipping public. In effect, the overstatement of the amounts credited to rail transportation expense was a form of price fixing. This was accomplished by increasing the amounts payable by REA to the railroads for their transportation services by $1.6 million per year, which increased the liability of REA to the railroads. In effect, by not deducting the sinking fund payment before computing rail revenues, the railroad directors increased the price charged by the railroads by $1.6 million over that authorized by the Commission. This increase then becomes a liability of REA when it was "advanced" to REA (bearing an above-the-market interest rate) which thus compounded the effect of the change.

The method of repayment adopted by the railroads, in contravention of the terms of the operations agreement approved by the ICC, in fact, resulted in an increase in the total costs of express services recoverable through the rates chargeable to users of the services. If the $32 million in gold serial notes had been retired in 20 years by semi-

annual payments of $800,000, as was contemplated by the agreement, REA would have been subject to charges of $48.72 million over the life of the notes, consisting of $32 million in sinking funds charged to REA Acct. 328 or 409, $16 million charged to Acct. 323—interest on funded debt, and $0.72 million charged to REA Acct. 325—amortization of discount on funded debt. The method of repayment that was actually employed, by direction of the railroad-controlled Board of REA, resulted in substantially greater total costs in respect of the original loan of $32 million. While no provision was made for charges of $32 million to REA Acct. 409 to meet the sinking fund payments, interest charges to REA Acct. 323 were increased to include interest on the amounts "advanced" to retire funded debt as well as the interest on the funded debt. Since 1929, interest payments directly traceable to the original gold serial bonds, together with interest on notes and "advances" which replaced the original bonds, have totaled $57.1 million. This amount is made up as follows:

Interest Payments	Security
(Millions)	
$12.2	5% Gold Serial Bonds (1929)
1.6	Series A Serial Notes (1938)
43.3	"Advances"
$57.1	Total

Interest costs of REA were and are properly includable charges in the determination of rates to the public for the handling and transportation of express traffic. Consequently, interest expenses for rate-making purposes were increased by the substitution of a system of advances for the sinking fund provisions contained in the original operations agreement presented to the ICC for approval in the amount of $43.3 million—the difference between interest payments on the initial $32 million debt of REA and actual

REA interest payments recoverable from the public through express rates.

Thus, Commissioner Mahaffie properly exhibited concern about the impact upon rates as a result of the acquisitions of the Express business by the railroads. The Commission's approval of the control of REA by the railroads undoubtedly was premised upon the representation that the plan as presented would have no rate effect whatever. However, the Commission was not told about the much different plan under consideration which was implemented by the railroads as soon as their control of REA was a fact. The revised method, with its increasing instead of decreasing interest payments, put a continuing upward pressure on rates charged to the public.

Further, it is obvious that, should REA now be required to pay the 1959 Notes and accrued interest thereon, the upward pressure on rates paid by the shipping public, should REA survive the ordeal, would be even more dramatic, amounting to a total of over $124 million paid from Express revenues since 1929 for the purpose of acquiring a property with a valuation of only slightly over $30 million.

The total is made up of the following elements:

Amount (Million)	Basis
$ 12.2	Interest 5% Gold Serial Bonds (1929)
1.6	Interest on Series A Serial Notes (1938)
43.3	Interest on "advances" paid through 1970
4.4	Accrued interest on 1959 Notes if payments were continued to June 30, 1974
32.0	Principal repaid on initial loan
4.0	Principal repaid on "advances"
27.0	Unpaid principal on "advances" (1959 Notes)
$124.5	Total

Included in this amount is interest on the original gold serial bonds, interest on notes and "advances" that replaced the original bonds and principal repayments on the "advances" which have totaled $61.1 million, since 1929. This $61.1 million plus the $32.0 million repayment of the initial gold bonds of 1929 makes total payments of $93.1 in principal and interest exclusive of the $31.4 million accrued interest and unpaid principal on the "advances".

2. The effect on rates of improper and economically unwarranted addition of interest costs on "advances" was intensified over the years because the railroads did not acknowledge that the interest payments received from REA were part of express income offsetting operating and capital costs incurred in providing express services. Instead, it was consistently represented to the Commission in express rate case proceedings during the years 1929 to 1959 in which the railroads sought increased revenues that rail transportation revenue ("express privileges") constituted ". . . the only compensation the railroads receive for transporting express traffic."[1] In fact, the stockholding railroads *received also* the payment of "interest" on the fictitious "advances" (which interest was at rates in excess of what would have been charged by independent lenders).

This served to shift REA cash payments from the "Express Privileges—Dr." account, for amounts paid to the railroads for their express services and thereby created

[1] Ex Parte No. 163, *Increased Express Rates and Charges*, 1946, Testimony of L. O. Head, July 29, 1946, page 8. See also: Ex Parte No. 169, *Increased Express Rates Charges*, 1949, Testimony of A. L. Hammell, September 7, 1949, page 8; Ex Parte No. 185, *Increased Rates and Charges*, 1953. Testimony of Fred Carpi on Cross Examination, May 4, 1953, pp. 223-4 and Docket No. 32035, *Increased Express Charges Within Eastern Territory* (1957), Testimony of C. J. Jump, page 11 and Brief of REA, page 4.

much of the deficit below fully allocated costs which the railroads experienced after 1940.

For example, Attachment 1, page 3, shows that the interest rate on the original gold bonds, and the notes which were substituted in 1938 for the bonds, declined from the full 1929 level of $1,600,000 per year to less than a quarter million dollars per year subsequent to 1940.

Yet, as is shown in both Attachments 1 and 2, the interest payments by REA never dropped below a million dollars. For example, in 1945 the interest on the notes was only $133,200. If the original plan outlined to the ICC in 1929 for the sinking fund had been followed (assuming as prudent businessman, REA using the 1938 refinancing would take advantage of the drop in interest rates that had taken place) the total interest of REA on its funded debt would have been only $133,200 in 1945.

In actual fact, 1945's interest payments consisted not only of the $133,200 to the outside note holders but also $1,130,429 to the railroads credited with the "advances". (Attachment 1, p.1) Together, they came to $1,263,629. (Attachment 1, p.6) • • •

Attachment 1 (LJE-1)
Page 6 of 6

REA EXPRESS
SUMMARY OF INTEREST EXPENSE

End of Year	Accrued Interest on Bonds and Notes	Interest Paid on the Advances	Total Interest Expense
1929	$ 1,320,000	$ —	$ 1,320,000
1930	1,513,300	66,000	1,579,300
1931	1,433,300	168,000	1,601,300
1932	1,353,400	264,000	1,617,400
1933	1,273,300	360,000	1,633,300
1934	1,193,300	455,906	1,649,206
1935	1,113,400	551,622	1,665,022
1936	1,033,300	540,191	1,573,491
1937	953,300	573,177	1,526,477
1938	1,015,600	666,416	1,682,016
1939	264,900	832,461	1,097,361
1940	254,200	730,429	984,629
1941	237,900	810,429	1,048,329
1942	217,600	890,429	1,108,029
1943	193,200	970,429	1,163,629
1944	164,900	1,050,429	1,215,329
1945	133,200	1,130,429	1,263,629
1946	93,200	1,210,428	1,303,628
1947	—	1,290,429	1,290,429
1948	—	1,370,428	1,370,428
1949	—	1,430,428	1,430,428
1950	—	1,430,428	1,430,428
1951	—	1,430,428	1,430,428
1952	—	1,430,428	1,430,428
1953	—	1,430,428	1,430,428
1954	—	1,430,428	1,430,428
1955	—	1,286,944	1,286,944
1956	—	1,143,651	1,143,651
1957	—	1,143,651	1,143,651
1958	—	1,143,651	1,143,651
1959 (9 Months)	—	953,042	953,042
Total	$13,761,300	$28,185,139	$41,946,439